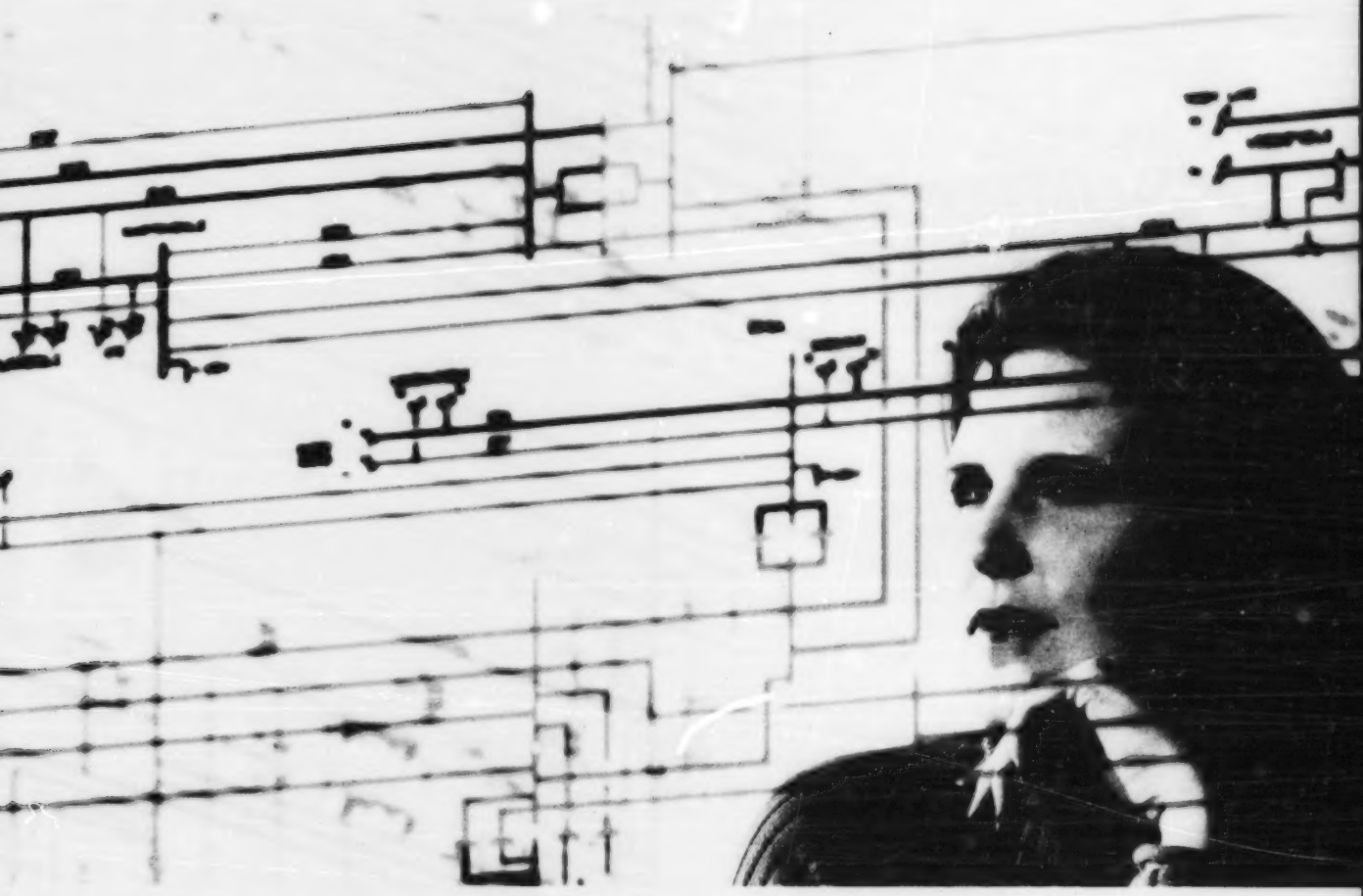
Connecting

at the speed of life



hydro One

92% market share

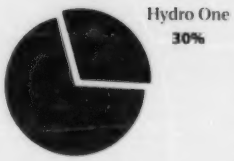
Hydro One is the dominant supplier to Ontario's electricity market. In 2000, we transmitted 147 TWh of electricity through our 28,500 kilometre transmission network, serving 53 municipal electricity utilities (MEUs), 66 large directly-connected industrial companies and our own distribution system.

Consolidation fuelling growth

Hydro One's 113,900 kilometre local distribution network serves about 30% of the Ontario market.

- 957,000 direct customers
- 38 large industrial customers
- spans entire province

Agreements have been reached to acquire 88 MEUs, subject to OEB approval.



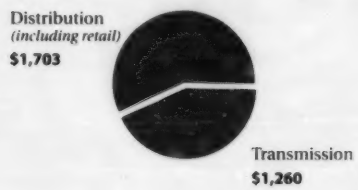
Hydro One Telecom markets excess fibre-optic capacity to telecommunications carriers. This business represents a significant opportunity to build a new business in a non-regulated sector.

- 2,000 kilometre fibre-optic network
- access to 129,000 kilometres of right-of-way and urban land holdings in Ontario

Ontario Hydro Energy provides Ontario retail customers with savings and innovative billing services for essential home services such as energy, telephone long distance, water heater rental, as well as home improvement. Ontario Hydro Energy also helps commercial and industrial customers improve profitability through energy-related products and management services.

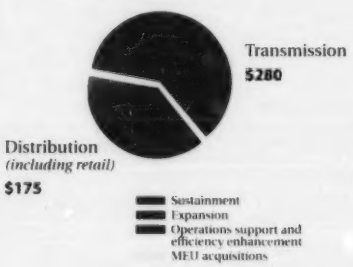
Revenue Breakdown *(Cdn $ millions)*

Year ended December 31, 2000



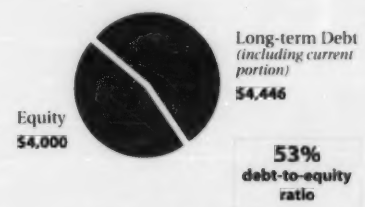
Capital Expenditures *(Cdn $ millions)*

Year ended December 31, 2000



Capital Structure *(Cdn $ millions)*

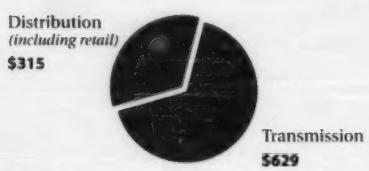
December 31, 2000



$8,446 million – Total Capitalization

Operating Income *(Cdn $ millions)*

Year ended December 31, 2000



Asset Deployment *(Cdn $ millions)*

December 31, 2000

FINANCIAL INFORMATION

(Cdn $ millions unless otherwise stated)	2000	1999	1998
Revenue	2,995	3,125	3,048
Operating income	925	918	829
Net income	378	375	270*
Operating cash flow	702	722	546
Approved ROE (%)	9.88%	9.35%	–
Long-term debt (including current portion)	4,446	4,845	5,619
Total equity	4,000	4,024	2,431
Net asset coverage on long-term debt	1.90	1.83	1.43
Interest coverage ratio	2.49	2.26	1.82
Transmission – units transmitted (TWh)	146.9	144.1	143.0
Distribution – units distributed (TWh)	17.6	18.1	18.3

**Without revaluation of the deferred pension asset*

ACCOMPLISHMENTS IN 2000

- Reached agreements to purchase 88 MEUs to date, subject to approvals, including Brampton Hydro, Ontario's sixth-largest MEU with 84,000 customers
- Completed second-largest corporate debt offering in Canada: a $1 billion inaugural debenture issue
- Improved labour productivity: gain sharing and more flexible working arrangements
- Created Hydro One Network Services to provide power line maintenance and construction, and forestry services to Hydro One Networks and other customers
- Launched new non-regulated business – Telecom and Retail Services

KEY STRENGTHS

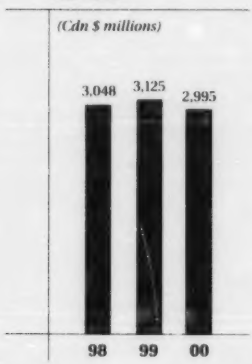
- Serving the largest market in Canada
- Regulated wires business – fee-for-service revenues
- Minimal exposure to electricity price fluctuation
- Superior credit ratings
- Solid interest rate coverage ratios
- Strong financial position: stable and predictable cashflows and conservative capital structure

GROWTH OPPORTUNITIES

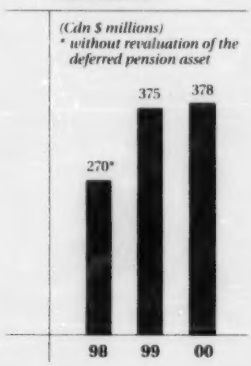
- Acquire and integrate MEUs
- Expand non-regulated business: Fibre-optic network
  Retail Services
- Pursue opportunities outside Ontario that lever our unique skills and capabilities
- Achieve operational excellence, lower cost and streamline operations

Hydro One is one of the 10 largest electricity transmission and distribution companies in North America. We're a new Company, but one that is founded on almost a century of operational expertise and experience, having inherited our businesses from Ontario Hydro on April 1, 1999. Hydro One's goal is to be the best in the energy delivery business by putting the customer first. We are the first and only company to deliver power right across the province of Ontario.

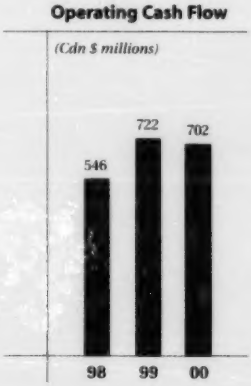
Revenue



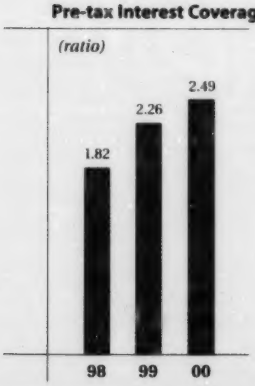
Net Income



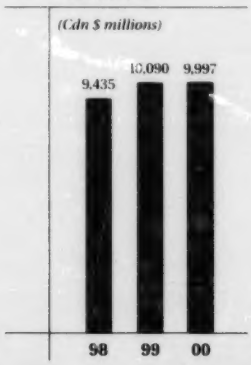
Operating Cash Flow



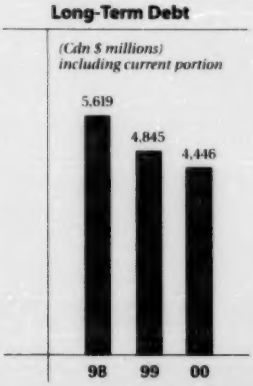
Pre-tax Interest Coverage



Total Assets



Long-Term Debt



Connecting

people & power

Hydro One owns and operates one of the largest electricity transmission and distribution systems in North America. More than 90% of the electricity consumed in Ontario flows through our high-voltage power lines, and our low-voltage lines directly serve approximately 30% of the market in the province. Through the Hydro One family of companies, we also provide a growing range of business and consumer services. For a more thorough description of Hydro One's subsidiaries, please see pages 18 and 19.

Our cover illustration, featuring employee Shelley Clayton and a schematic of our electricity grid, brings together the core strengths of Hydro One – our people and our ability to manage a very large and sophisticated network. The fusion of highly skilled employees and extensive assets mirrors the way we help our customers to meet their current needs and realize their aspirations – to connect at the speed of life.

Shelley is a Field Business Coordinator in the Distribution Operations Management centre in Markham.

102-00569/

12 From the C...

14 From the Presi...

18 Operating Subsidiar...

20 Operating Highlights

22 Environment, Hea... and Safety Highlights

25 Management's Discu...ion and Analysis

44 Consolidated Financial Statements

48 Notes to Consolidated Financial Statements

70 Five-Year Summary of Financial and Operating Statistics

72 Board of Directors

74 Board Committees

75 Senior Officers of the Company and Operating Subsidiaries

76 Corporate Information

Hydro One has videotaped every kilometre of its network, enabling us to pinpoint downed lines within minutes, assess response urgency and dispatch repair crews to the precise location of the problem. This troubleshooting is a key factor behind the reliability of our network.

Real-Time Asset Management
The Transmission Operations Management Centre (TOMC) is a 24-hour operation which provides real-time asset management of Hydro One transmission assets and has accountabilities which include supervising the operation of the provincial 500 kV, 230 kV and 115 kV transmission network. TOMC responsibilities also include planning and scheduling transmission outages, conducting operating assessments, monitoring the performance of operations and operating tools, and managing the future operating infrastructure.

Graphical Representation of Our Grid
The large map in the centre of this photo shows a "circuit" representation of the Hydro One network. Red lines represent 230 kV circuits, green 115 kV circuits and blue the larger 500 kV circuits. Yellow lines indicate circuits that are out of service. At the terminal points of many of the circuits are rectangular bars that represent generation stations as well as distribution points and the interconnections to neighbouring provinces and states.

Ensuring Electricity Delivery
Skilled Hydro One TOMC and field operating staff actively monitor and control the transmission network. Using computerized tools, the Hydro One operators assess the impact of planned outages and the quality of supply to customers and the impact on equipment. They also react to forced outages to transmission and distribution circuits, identifying and prioritizing restoration. In some cases a decision is made to recall planned outages in order to prevent customer interruptions due to storms in the area that could threaten customer supply.

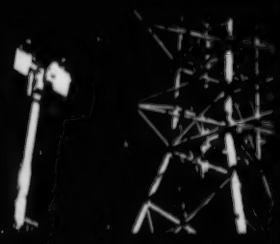
Hydro One's 28,500 kilometre transmission network is the backbone of a power delivery grid that supplies more than 90% of Ontario's electricity market. That critical network, one of the largest in North America, is monitored and controlled from a state-of-the-art centre in the north end of Toronto called the Transmission Operations Management Centre, or TOMC.

Twenty-four hours a day, seven days a week, Hydro One operators at TOMC track weather conditions, load factors and line conditions throughout the province-wide network. They also carefully monitor line maintenance and, in association with field operators, can quickly take steps to remedy interruptions to power supply by directing crews to the site of unexpected disruptions. Every kilometre of Hydro One's high-voltage transmission lines has been videotaped by air so that operators at TOMC can get a clear idea of the terrain at any specific location.

A key variable in maintaining Hydro One's high level of service reliability is the weather, which is monitored closely across the province with the help of Environment Canada and other weather forecasts and the Ministry of Natural Resources' lightning tracking system. By closely following weather conditions and projected storm paths, operators can prepare parts of the grid to avoid or mitigate potential power disruptions, sometimes even dispatching crews in advance.

Connecting

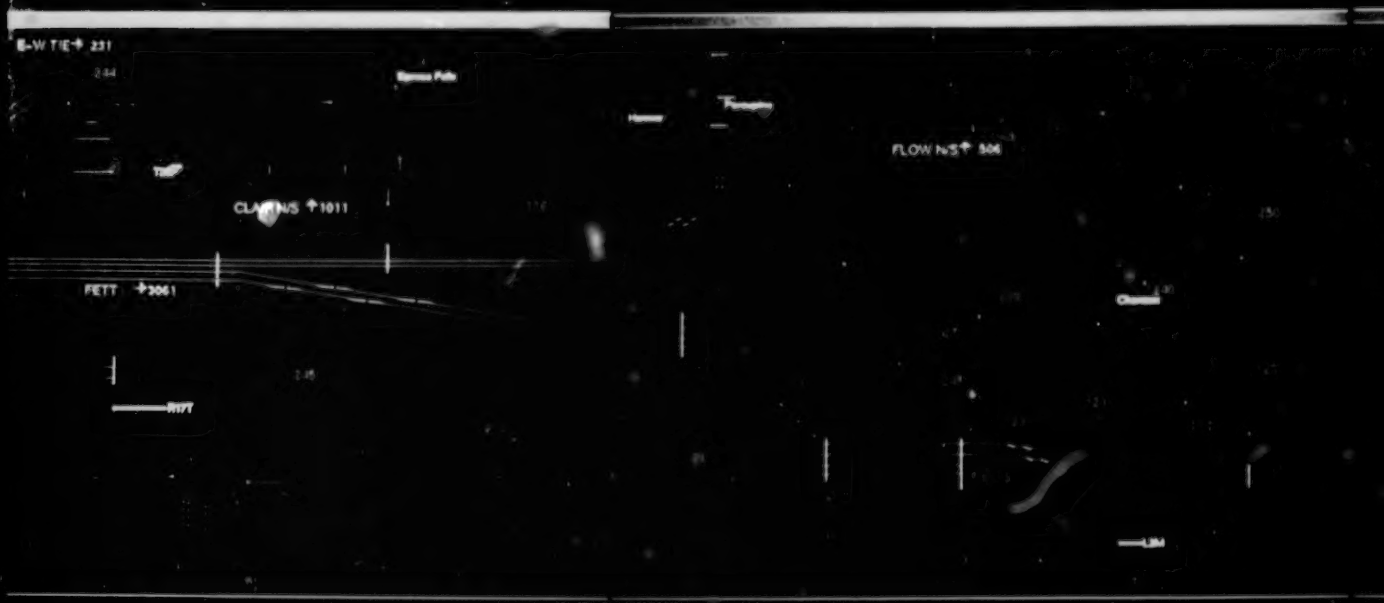
with our network



Hydro One owns and operates the high-voltage power transmission network in Ontario. Approximately 92% of the electricity consumed in Ontario flows through our network.

Hydro One serves approximately 30% of the low-voltage local distribution market in Ontario, and has been expanding its reach through acquisitions primarily, but not exclusively, in rural and remote areas.

Bruce Nuclear Power Development

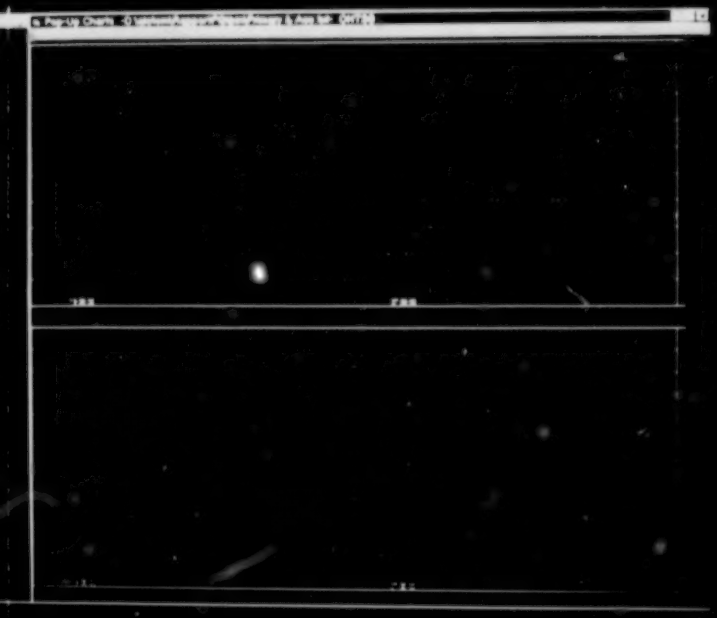


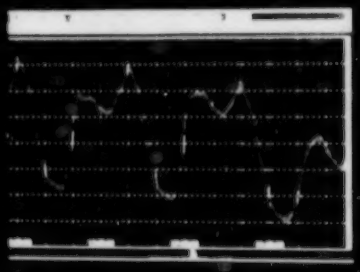
Forestry is an important part of Hydro One's efforts to ensure reliability of supply, particularly in rural locations. Company personnel maintain Hydro One's rights way of way, both on a routine, and emergency, basis.

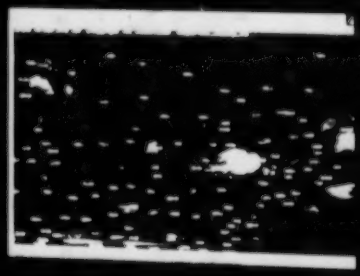
Bruce Casselman / Forestry

In a project with Detroit Edison, two new Hydro One "phase shifters", along with a new auto-transformer on the Michigan side, will increase export capability by 1,000 megawatts and import capability by 500 megawatts.

L to R - Pat Geldimis, Bryan Budkin, Rodney Jurlali, Dan Bennett and Ivan Speedie







L to R, Andy Poray, Steve Dorey, Jatin Nathwani and Giuliana Rassani / Strategic Planning

John MacDonald and Rudy Kerec / Lines

THE HYDRO ONE WAY

- **Treat all of our people with respect;**
- **Provide a safe work environment;**
- **Provide a clear statement of responsibilities and accountabilities and hold people accountable for results;**
- **Provide the training and coaching required to be a top performer;**
- **Communicate in all directions throughout the Company, sharing as much information as possible;**
- **Recognize, celebrate and reward success.**

Guiding principles

- **Think first about the customer and be responsive to customer needs;**
- **Insist on integrity in what we do and how we do it;**
- **Be conscientious, continuously improving and forward-looking;**
- **Minimize the risk of injury to the public;**
- **Treat environmental protection as a key to our success.**

Allison Gibson / Meter Reader

Connecting

with our employees

> Encouraging a Vibrant Corporate Culture

Hydro One's journey to becoming a competitive commercial enterprise has been both invigorating and challenging. And we are making substantial progress.

It is a process that is well underway and is resulting in an important new relationship with employees. At Hydro One, we have developed a set of values – known as the Hydro One Way – to help us achieve good working relationships with employees and customers.

Over the past two years, Hydro One has reached agreements with its two bargaining groups – the Power Workers' Union and the Society of Energy Professionals – that reflect a new sense of purpose. Among other achievements, the new agreements allow for greater labour flexibility.

> Building on Strength

The Company has a number of important strengths to draw on as it goes through the sometimes daunting process of realigning its entire corporate culture.

First is the expertise and experience of Hydro One employees – a skilled workforce that has tremendous know-how in simply getting the job done.

Second is the realization within the organization that change is necessary. Reregulation is recasting the industry throughout North America. This is leading to more open markets and increased competitive pressures. No organization is immune.

Finally, there is the understanding that the new reality brings some exciting possibilities. Organizations – and employees – that manage the transition successfully will benefit from new opportunities and greater rewards.

Hydro One has been focusing on fundamental issues such as compensation, training and communications to push the change agenda forward.

> Linking Compensation to Performance

There is a new emphasis on variable compensation tied to performance. More compensation is now related directly to individual and corporate performance. We have also taken steps to ensure that the top tier of managers has incentive programs that align their performance with the success of Hydro One. The focus is not simply on profitability, but on other targets as well, including health and safety, productivity and growth.

> Increasing Emphasis on Training

A new program of front-line manager training has been introduced, instilled with the new values of Hydro One. In addition, the 300 most senior people in the organization are participating in a new leadership development program, Transformation Through Leadership.

> Communicating with Employees – a Priority

Employee communications have been enhanced throughout the Company through a focused internal communications program. President and CEO Eleanor Clitheroe leads an annual employee tour that includes visits to every major Hydro One site, making contact with all employees across the province. And more than ever before, employee views and concerns are being tracked and managed. A comprehensive employee survey undertaken in 2000 is being followed up this year to measure progress on key issues. The initial survey has led to changes in Hydro One's training, communications and other programs.

Hydro One owns and operates the major electricity transportation networks in Ontario. We are the dominant transmission and distribution player in the province.

Connecting

facts & figures

How can a bird sit on a live wire and not get a nasty shock? After all, she's directly connected to the electricity flow in the wire. The answer is in isolation. If the bird doesn't touch another wire or a grounded surface, she won't form a circuit and the electricity won't conduct through her.

RELIABLE ELECTRICITY DELIVERY

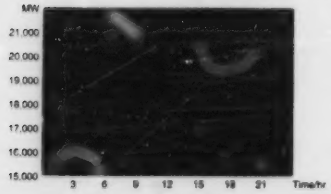
Hydro One monitors power demand variability over its entire electricity delivery network, 24 hours a day, seven days a week. Over the course of a year, this demand reflects the life patterns of Ontario.

The chart on the left shows a typical winter weekday in the province. Ontario wakes up around 5 am, and switches on at home and at work. Offices and manufacturing plants gear up for a productive day, increasing the need for electricity. By 9 am the power demand has hit working day levels, slowing slightly by quitting time, only to ramp up again as daylight fades and the lights come on all over the province. Power demand begins to decline around 9 pm as Ontarians end their day.

The chart on the right shows a slower demand cycle for Ontario – an average winter Saturday. The province sleeps a little later, with power demand starting to ramp up at 6 am. Lights go on and breakfast is prepared. By noon, Ontarians are ready to run errands or spend some leisure time outdoors. Consequently, power demand dips to a late afternoon low. By 5 pm dinner plans are well underway, lights are turned on, and evening entertainment begins, creating a power demand peak at 7 pm. This peak will be more gradual as summer comes and daylight lasts longer, reducing the need for lighting. By 8 pm, the province is settling in for the night and demand slackens.

All over the province, every hour of the day, every day of the year, Hydro One delivers the electricity Ontarians need for work and play. This is the fundamental strength of Hydro One – reliable electricity delivery.

Primary Power Demand – all Ontario



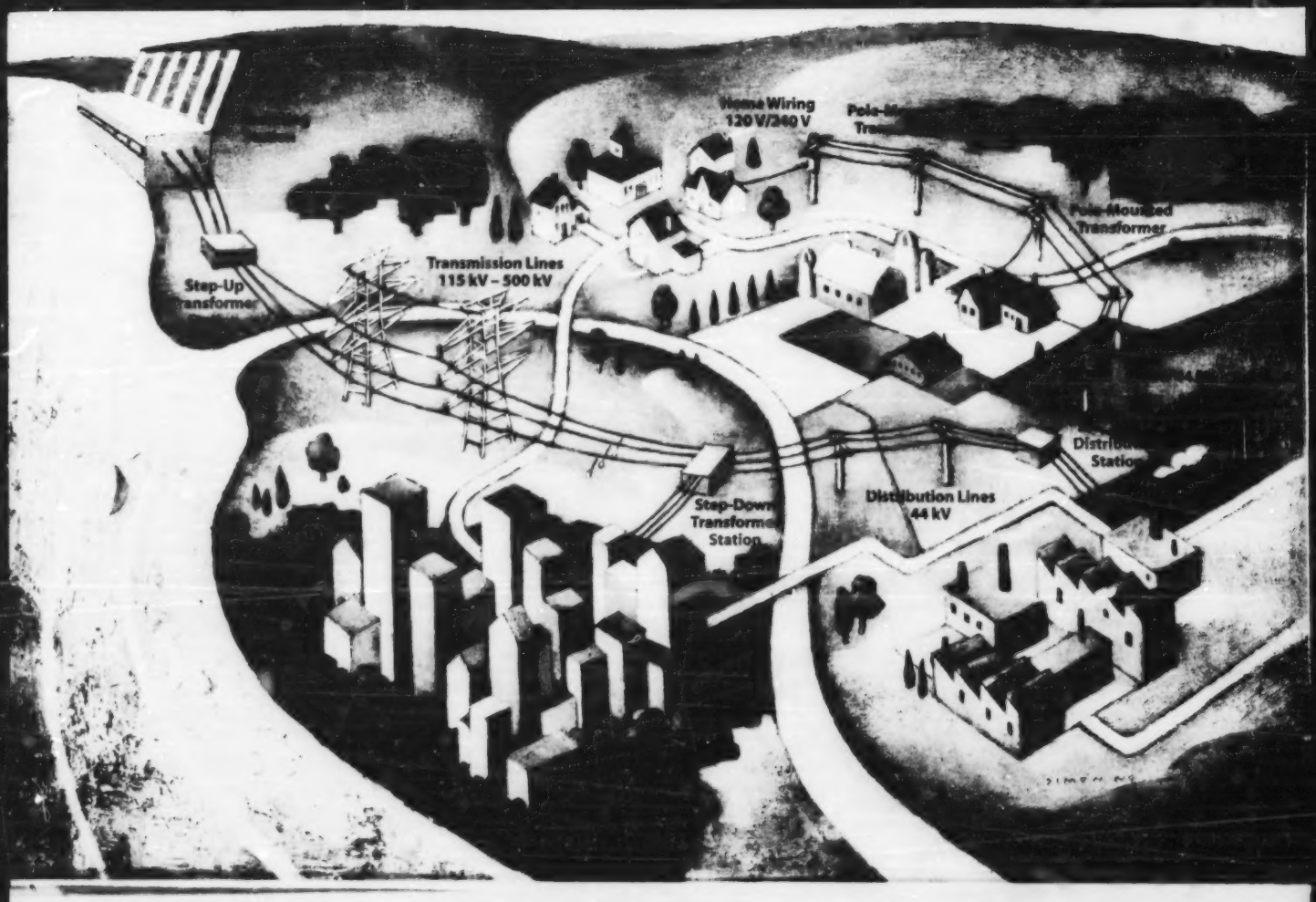
Thursday, March 1, 2001

Saturday, February 24, 2001

DID YOU KNOW?

> Moving Electricity Under Ideal Conditions

High-voltage power lines can transmit more electricity if they are cool. The problem is, as the load increases, lines tend to heat up, and as they grow hotter the lines tend to sag between the pylons or towers. The best time to move electricity is at night, when it's windy. Wind helps to cool down the lines, while the sun heats them up. However, peak demand for electricity is during daylight hours, which means Hydro One operators must closely monitor the lines' loading to ensure that there are no overloads when customer usage is highest.



> Aluminum Helps Foil Weight Problem

Most high-voltage lines in Hydro One's grid are made of steel-reinforced aluminum. Aluminum provides superior conductivity through a lightweight cable. One of the best conductors of electricity is gold, but even at recent prices, it's far too expensive and, in any event, it's much too soft a metal to be used in this application.

> Connecting the North

Hydro One is working with the First Nation communities of Attawapiskat, Fort Albany and Kashechewan to construct the Omushkego Ishkotayo transmission line along the western coast of James Bay. This 270 kilometre high-voltage line will link these remote communities to Hydro One's grid at Moosonee. Hydro One will purchase the substation there as well as 79 kilometres of the line itself. These remote communities presently rely on generators, operated by Hydro One Remote Communities, for their power. Connectivity with Hydro One's grid is expected to be a catalyst for economic development in the region. In an environment where there are only three snow-free months a year and temperatures drop to –40° Celsius, Hydro One's know-how in operating electricity grids under extreme climatic conditions is proving essential.

> Lending a Hand

In December 2000, Hydro One showed that its links to the northeastern United States went beyond transmission line interconnects. On December 12, hundreds of thousands of people in New York and Pennsylvania were without power following a series of severe winter storms. At the request of Niagara Mohawk and General Public Utilities, almost 160 Hydro One professionals assisted in restoring power to our neighbouring communities in the U.S. Drawn from across the province, from Dundas to Kingston, these lines staff and mechanics demonstrated the professionalism and highly specialized skills that characterize Hydro One.

Connecting

with our customers

> A Focus on the Customer

As Hydro One prepares for open markets, there is a keen recognition that improving service and satisfying customers can help increase operational efficiencies, enhance our reputation and support growth.

For Hydro One, the advent of open markets presents tremendous opportunities – the chance to lever skills and experience – enabling entry into new markets and an expansion of service offerings. The true measure of our success will be best-in-class competitiveness in all areas, including customer relations.

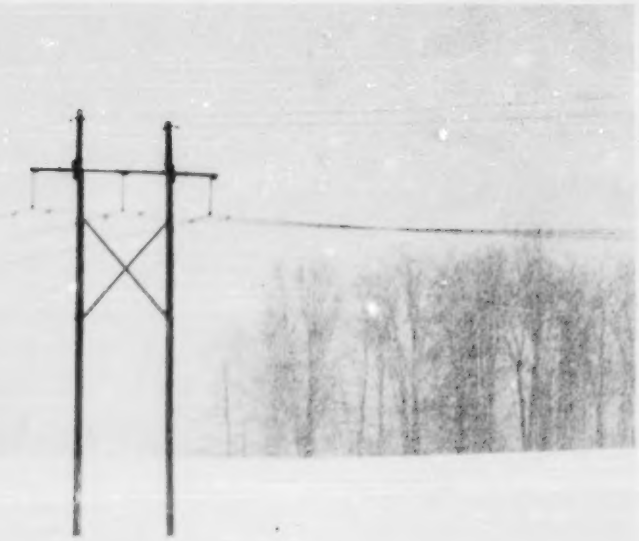
> Customer Satisfaction is a Priority

In December 1999 we launched our Customer Satisfaction Management Program to help prioritize customer service initiatives. This began with customer feedback. We conducted mail surveys and one-on-one interviews covering six customer groups. We identified and examined customer expectations and developed service performance measurements. Our initial findings indicate that we met or exceeded service quality standards of the Ontario Energy Board (OEB).

We are scrutinizing our performance against satisfaction criteria established by this process. Customer insight gained in this effort will also direct new customer service initiatives.

> Faster Connections

New connections emerged as one service area requiring improvement. Hydro One makes roughly 20,000 new connections and service upgrades each year and



Single circuit H-Frame wood pole structure, 115 kV transmission line / Collingwood, Ontario

For Hydro One, the advent of open markets presents tremendous opportunities – the chance to lever skills and experience – enabling entry into new markets and an expansion of service offerings.

customer feedback revealed the need for faster response. We remedied this issue by committing to a 24-hour initial response time and improved scheduling and logistics. These changes have improved customer satisfaction. Moreover, they are expected to generate more than $1 million in annual savings through efficiencies.

> Welcoming New Customers

We are welcoming 240,000 new customers to Hydro One as a result of agreements to acquire 88 municipal electricity utilities. We prepared a personalized welcome package, including a detailed outline of services, and delivered it to each new customer. So far, 80% of those contacted after the mailing recall receiving our welcome kit – a very high level of acknowledgment. They reported a good understanding of, and satisfaction with, the transition process as well as the potential benefits arising from it.

> Focusing to Serve Retail Customers Better

Our recently-created subsidiary, Ontario Hydro Energy, will enhance the delivery of our retail services. Its mandate is to provide an expanded range of services, from electricity to long distance telephone to residential services, in a responsive and direct way. Among Ontario Hydro Energy's first initiatives was the transfer of 160,000 water heater rental service customers. A potentially confusing hand-over was managed smoothly through rigorous planning, staged communication, and careful migration of call handling and billing.

> Clearly Communicating Change

Over the past 12 months, Hydro One hosted a series of Transmission Connection Agreement Seminars across Ontario. Their purpose was to clarify the roles and responsibilities of Hydro One Networks and customers who are connected to the high-voltage transmission system. The seminars were supported by a series of information packages that provided regular updates on the process.

Meeting *the challenge*

As one of the leading wires businesses in North America, Hydro One is proud of the fundamental role we play in the lives of families and businesses across this province. The delivery of electricity has become so transparent in our everyday lives that most people never need to consider the vast and sophisticated network being tapped into when they reach for the light switch. This transparency, and the confidence it creates, has been earned through decades of safe and reliable delivery of electricity.

arrell and daughter Alicia
ydro One Networks

Sir Graham Day
Chairman

This Statement seeks to inform the shareholder, those who hold our public markets fixed income debt, and other Hydro One stakeholders, of significant aspects of last year's operations and those which are likely to influence the Company's prospects.

Hydro One is engaged almost wholly in "fee-for-services" wires related businesses: electricity transmission and distribution and telecommunications. The Company continues to exhibit the positive impacts of a superior management team, clear strategies, a commitment to positive change and a demonstrated ability to deliver.

In financial terms, Hydro One continues to perform well. However, in order to continue to deliver good financial results in a performance-related regulatory environment, the Company must further reduce its costs. To this end, a number of accomplishments in 2000 are contributing to a more competitive cost structure.

Under a voluntary retirement programme, total regular employment was reduced by almost 25 percent. A new one-year collective agreement with the Power Workers' Union was signed which included relating an element of compensation to corporate performance: gain sharing. Also, this agreement introduced more flexible working arrangements.

Into the medium term, cost challenges will relate principally to lower-skilled, seasonal and occasional work. Management of these costs is important both to ongoing operations and as Hydro One continues to improve the condition of its wires assets and the rights of way over which they run.

The totally successful transition of Hydro One's computer based systems through January 1, 2000 masked enormous work done to meet the "Y2K" challenge. Important continuing benefits, including reduced costs, resulted from a mix of critical review, remediation and replacement of the Company's computer programs.

Hydro One is charged by the shareholder to replace the debt allocated to the Company on its creation, and guaranteed by the Province of Ontario, with new Hydro One debt raised in the public markets without guarantee. In June, a very well-received initial $1 billion bond issue was sold by Hydro One to Canadian and United States investors.

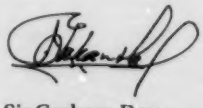
Hydro One is growing to enhance shareholder value. As a result of the consolidation of a very fragmented provincial electricity distribution system, by the year end, subject to approvals by the Ontario Energy Board, Hydro One had entered into agreements to purchase 88 municipal electricity utilities. The great majority are "embedded" within the geographic coverage of the Company's original distribution system. These acquisitions will enable cost savings, principally through the elimination of duplication and the spreading of indirect costs over a larger base.

Hydro One Telecom has the second largest telecommunications network in Ontario. This new subsidiary is free to deploy commercially the surplus capacity of the fibre-optics network heretofore restricted to use for electrical wires protection purposes. This network is expanding and being enhanced as an obsolete microwave system is replaced with fibre, through selective acquisitions and by new connections. In 2000, Hydro One Telecom signed contracts with several first-class user and primary telecommunications companies for both dark and lit fibre capacity.

Our competitive energy services subsidiary, Ontario Hydro Energy, will not contribute meaningfully until, in accordance with provincial government policy, there is an open electricity market in Ontario.

In this year, 2001, I expect to see the Company building successfully on the foundations laid by the many initiatives taken since the commencement of business on April 1, 1999. Hydro One has the assets, the management and the people required to maintain its position as one of the leading wires businesses in North America.

On behalf of the Board of Directors, and personally, I extend sincere thanks to Hydro One's employees for their solid contributions to a good 2000 performance and for their continuing commitment to delivering quality service at a fair price.



Sir Graham Day
Chairman
March 13, 2001

Creating *value*

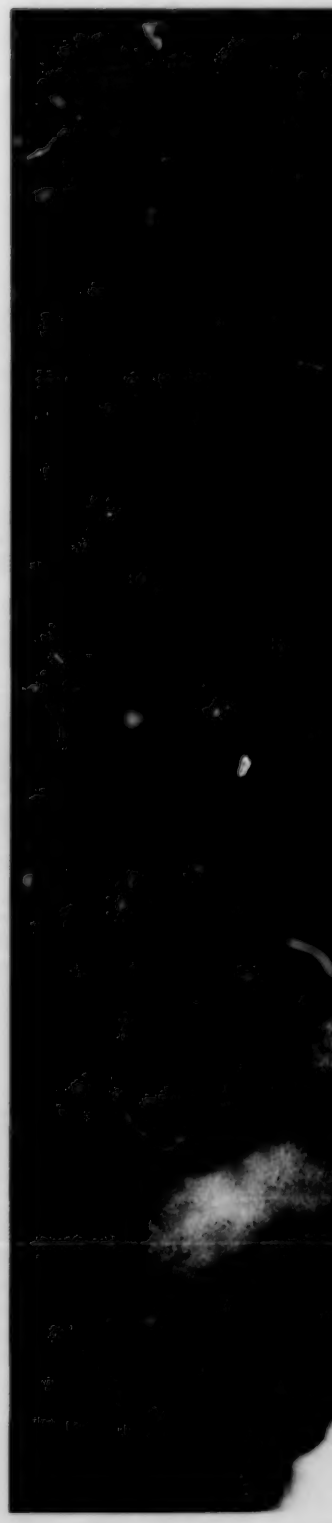
Eleanor Clitheroe
President and
Chief Executive Officer

> An Agile Company

In 2000, we took significant steps to change the way we do business. We streamlined processes, improved productivity and continued to create value for our shareholder, our customers and our employees. As a result, Hydro One is emerging as an agile company positioned to adapt effectively to a dynamic marketplace with safe, cost-effective and reliable electricity delivery. As our flexibility increases we are contemplating new ways to use it to realize the full value of our comprehensive network capabilities. These will include retail services when the competitive market opens in Ontario as well as the levering of our fibre-optic network.

> Unparalleled Technical Expertise

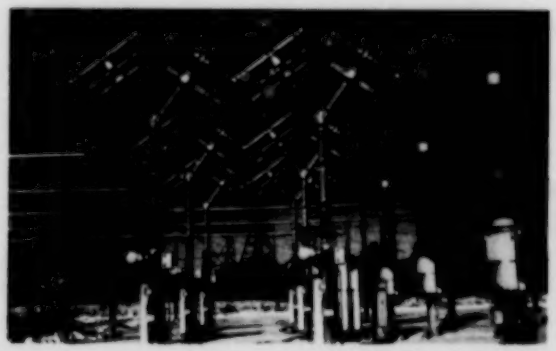
We are a workforce that is committed to developing the best electricity transportation business in the world. Hydro One employees are highly trained and perform specialized duties that assure the reliability of the electricity network in Ontario. This wealth of expertise is unique to Hydro One. When Hydro One employees replace components on the top of a transmission tower, ride up in a bucket to increase line tension on a distribution line or monitor transmission loads every hour of the day, they are working to maintain the dependability of Ontario's electricity transportation network, a vital part of the province's infrastructure. In so doing they are applying the unparalleled technical expertise that is fundamental to the success of Hydro One. This is one of our principal assets – knowledge.



Scheduled feather (transmission tower arm) replacement / Mississauga

From the President and CEO

...Hydro One is emerging as an agile company positioned to adapt effectively to a dynamic marketplace with safe, cost-effective and reliable electricity delivery.



500 kV breakers / Cherrywood TS

Wood pole replacement / Allanburg

> Building on Our Strengths

Year 2000 proved an auspicious start for Hydro One as we built on our long-established strengths in a number of critical areas.

We completed one of the most successful bond financings in Canadian history – a clear expression of the investment market's confidence in Hydro One and the strength of our position. We have earned superior credit ratings from ratings agencies in the United States and Canada.

We purchased 88 municipal electricity utilities to help create a more efficient, integrated delivery system.

We made significant progress as we launched a number of new business initiatives and introduced our new Hydro One name and brand.

We reduced staff and overhead substantially through a voluntary retirement program that resulted in a reduction of approximately 25% in our regular workforce, while reorganizing responsibilities so that service and reliability were not affected.

We recruited new talent in a number of areas of our organization, including the addition of key people at the senior management level.

We continued with the expansion of our interconnection capabilities through important projects that expand our links with Michigan and Quebec.

> Strong Financial Results

In 2000, Hydro One net income increased $3 million to $378 million, despite a small decrease in revenue. Revenue declined 4% to $2.995 billion as distribution revenues were reduced by 5%, primarily due to lower retail demand for electricity. Revenue in 1999 included the contribution from interests in foreign operations, which were sold.

Earnings benefited from the higher rate of return allowed by the Ontario Energy Board, combined with a decline in costs, largely as a result of a reduction in our workforce and the realignment of our efforts.

Our operating costs will continue to decline as we find efficiencies throughout Hydro One, and as a result of the reduction in our workforce, primarily through voluntary retirement.

> Preparing for Open Markets

The opening of the electricity market is a challenge facing all electrical utilities in Ontario. Hydro One will

continue to manage the transition to a competitive marketplace in a sound, businesslike manner.

We have a firm commitment to be ready when the market opens. To that end, we have been working closely with the Independent Electricity Market Operator and the Ontario Energy Board to ensure our preparedness in every area of the organization. Before the end of this summer we will have completed the design, building and internal testing of the systems that will be required when open markets occur.

Compared to other jurisdictions, we look ahead to open markets with a much stronger infrastructure in place. Interconnection is one example. Hydro One already enjoys strong network connections with Quebec, New York and Michigan as well as Manitoba and Minnesota.

We also have plans in place to increase Ontario's interconnection capability with other utilities by approximately 40%, providing even greater flexibility to increase flows of electricity from Quebec and Michigan.

> Our Family of Companies

At Hydro One, we will continue to develop our new business units within our family of companies and strengthen the base of our core transmission and distribution business. We will continue to acquire municipal electricity utilities when opportunities arise and when it makes business sense. We plan to execute a growth strategy, building on Brampton Hydro's management and staff expertise to create a strong urban wires business.

We will be looking at new ways to partner with municipalities, including the provision of management and operating services to help them deal with a more complex operating environment. The formation of an e-services business will allow us to provide back-office functions, such as billing, call handling, and e-enabled businesses to other utility customers.

We are also interested in opportunities to own, manage or service high-voltage wires beyond Ontario's borders.

We continue to grow our other subsidiaries. On January 1, 2001 we separated the services side of our Hydro One Networks business, creating one of the largest electricity transmission and distribution services companies in Canada – one that can be positioned to provide services to other customers, both in Canada and the U.S.

Our Hydro One Telecom subsidiary has already been successful in leasing excess fibre-optics capacity to telecommunications providers.

Ontario Hydro Energy, our competitive retail subsidiary, continues to acquire both business and residential customers at an impressive rate. The unique residential offering includes competitively-priced energy, long distance and home improvement services – all on one bill.

> Experienced, Dedicated People

The spark for our ambitious programs is a strong management team backed by the skills and dedication of an experienced group of employees.

We are also supported by a strong Board of Directors. I wish to thank the Board, and in particular, Sir Graham Day, Chairman, for their continuing counsel and guidance.

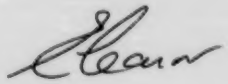
On May 26, 2000 an experienced construction line journeyman, Bruce Halladay, was killed while working on a transmission tower in the Toronto area. Bruce was an outstanding employee with a young family. We mourn his loss.

This unfortunate accident is a painful reminder of the potential workplace hazards that surround us. Safety is our top priority and we must be vigilant about proper safety measures.

> The Hydro One Way

Strong working relationships with our employees and our customers are essential to our future success. We have identified a required set of values to help us achieve those kinds of relationships. That set of values – which we call the Hydro One Way – describes the types of behaviours that we must adopt in our dealings with our colleagues and our customers.

Not only are we going to be a successful company, but we are going to achieve that success in a way that we value – the Hydro One Way.



Eleanor Clitheroe
President and Chief Executive Officer
March 13, 2001

Operating

The Hydro One family of companies consists of six wholly-owned subsidiaries.

Hydro One Networks Inc.

MALEN NG – *President and CEO of Hydro One Networks*

Ron Taylor

Hydro One Networks Inc. operates the largest transmission and distribution system in Ontario and one of the 10 largest systems in North America. The transmission system includes 17 interconnection facilities that connect the province with systems in neighbouring provinces and U.S. states and allow electricity to flow into and out of Ontario.

The distribution system delivers power to approximately one million customers in Ontario including residential, agricultural, commercial and industrial end-users, and smaller utilities. Hydro One Networks is regulated by the Ontario Energy Board.

Hydro One Network Services Inc.

ROD TAYLOR – *President and CEO of Hydro One Network Services*

Hydro One Network Services Inc. provides services, beginning in 2001, to Hydro One Networks, including power line maintenance and construction, and forestry. Network Services also bids on non-Hydro One Networks business. It is one of the largest electricity transmission and distribution services companies in Canada, offering an exciting new growth opportunity for Hydro One.

Hydro One Telecom Inc.

JOAN PRIOR – *President and CEO of Hydro One Telecom*

Hydro One Telecom Inc. carries on all business relating to the operation of fibre-optic telecommunication systems and facilities for Hydro One. It has a mandate to launch a carrier's carrier telecommunications service by leasing the excess capacity on our fibre-optics communications systems to telecommunications providers.

subsidiaries

Ontario Hydro Energy Inc.

MIKE MULLER – *President and CEO of Ontario Hydro Energy*

Lisa Sheridan and Sabrina Scaletta

Ontario Hydro Energy Inc. is the competitive retail subsidiary of Hydro One. Serving residential customers under the name Onsource (www.Onsource.ca), it provides a one-stop source for essential home services including energy, long distance service, water heater rental and home improvement services. Ontario Hydro Energy (www.OntarioHydroEnergy.com) also assists commercial and industrial customers to improve profitability through energy-related products and management services.

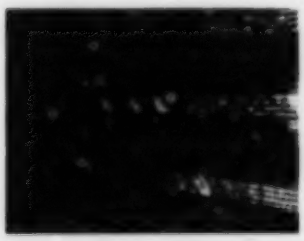
Hydro One Remote Communities Inc.

LES HORSWILL – *President and CEO of Hydro One Remote Communities*

Hydro One Remote Communities Inc. operates and maintains the generation and distribution assets used to supply electricity to 20 remote communities across northern Ontario which are not connected to Ontario's electricity grid.

Hydro One Markets Inc.

KATHRYN BEATON – *President and CEO of Hydro One Markets*



Hydro One Markets Inc. is responsible for wholesale power procurement and related settlement services for Hydro One Networks. Once Open Access is in place, this will mean purchasing power for Networks' standard supply customers at competitive market rates directly from the province's electricity spot market and managing receipt of Networks' transmission revenues from the wholesale market.

Operating

- *Eighty-Eight Local Utilities to Join Hydro One*
- *Brampton Hydro Purchased*
- *Record Bond Issue Oversubscribed*
- *Hydro One Brand Launched*
- *Rating Agencies Rate Hydro One Highly*
- *Workforce Reduced Through Retirement Program*
- *Success in Union Negotiations*

> Eighty-Eight Local Utilities to Join Hydro One

Hydro One has purchased, or entered into agreements to purchase, 88 municipal electricity utilities (MEUs), or almost a third of the MEUs in the province. Most of these are small companies embedded within Hydro One's existing distribution network, allowing for significant economies of scale as we apply our fixed infrastructure costs to a larger customer base. The 88 utilities have a total customer base of about 240,000, bringing Hydro One's total customer base to approximately 1.2 million.

> Brampton Hydro Purchased

Hydro One agreed to acquire Brampton Hydro from the city of Brampton, the largest purchase of a municipal electricity utility in 2000. Brampton Hydro will be operated as a wholly-owned subsidiary of Hydro One and will serve as the flagship for the Company's entry into urban markets. Brampton Hydro was the sixth-largest municipal electricity utility in Ontario with 84,000 customers and 1999 revenues of more than $200 million. The acquisition brings special urban network skills and experience to complement Hydro One's largely rural distribution business.

highlights 2000

> Record Bond Issue Oversubscribed

In June 2000, Hydro One completed the second-largest debt offering ever in Canada, an initial public offering of $1 billion. Proceeds of the offering were used to repay a portion of the Company's indebtedness to Ontario Electricity Financial Corporation. The issue was originally intended to raise $750 million; however, an enthusiastic reception by the capital markets enabled the Company to increase the offering by $250 million.

> Hydro One Brand Launched

With a bold new logo, Hydro One was officially unveiled on May 1, 2000, marking an important step in the creation of a strong identity for one of Canada's newest and largest corporations. Our name embodies the essential nature of the service the Company provides and the excellence with which our employees deliver that service.

> Rating Agencies Rate Hydro One Highly

Hydro One earned superior long-term credit ratings from the major North American rating agencies during 2000. The ratings reflect the investment community's confidence in the financial strength of Hydro One.

> Workforce Reduced Through Retirement Program

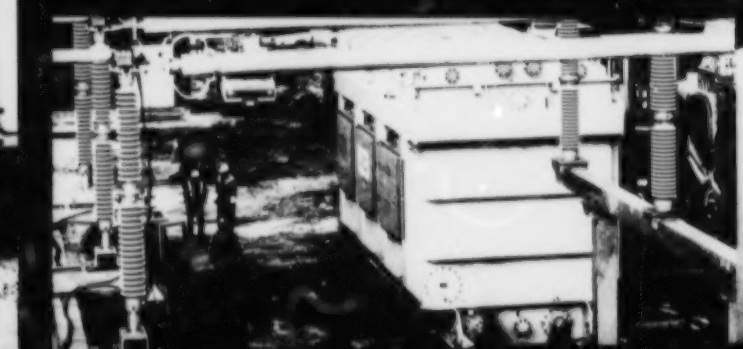
Approximately 25% of Hydro One's regular employees chose to accept an early retirement package in 2000. This reduced the number of regular employees at Hydro One by about 1,400. A company-wide consolidation of work centres and redesign of work processes ensured a smooth transition and has increased efficiencies while protecting standards of performance and reliability.

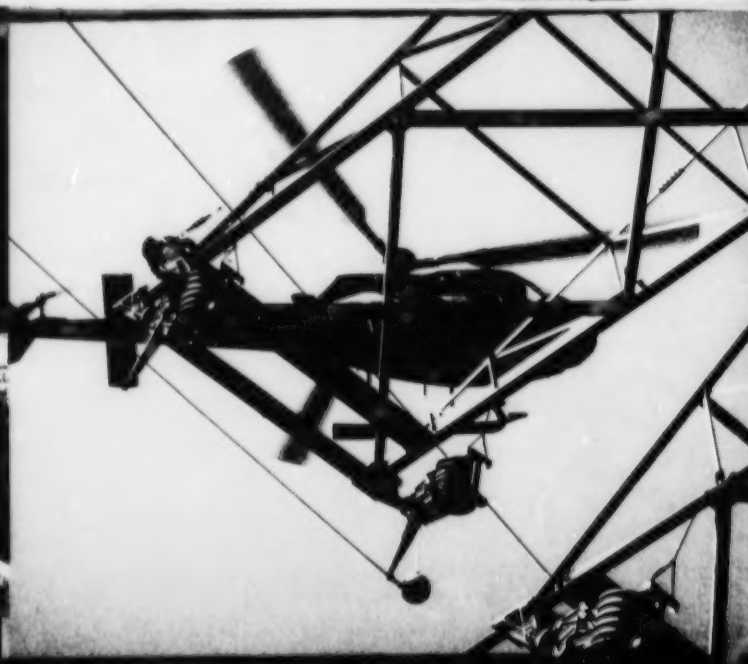
> Success in Union Negotiations

New contracts were signed with the Power Workers' Union (PWU) and, early in 2001, with the Society of Energy Professionals. Hydro One has been able to introduce incentive pay into compensation agreements with both major unions, an important step in the Company's transition to competition. It's also indicative of the cooperative spirit between Hydro One and its employees as the Company prepares for open markets. The joint bargaining committee in the PWU negotiations won the President's Award for Innovation in the Workplace in 2000.

Every mile of Hydro One transmission lines has been videotaped from the air to aid in trouble-shooting and emergency service. >>

<< To improve Ontario-Michigan power interconnections near Sarnia, Ontario, Hydro One is installing two new phase shifters at its Lambton transformer station.





Environment,

> A Mandate for Safety

At Hydro One, health, safety and the environment are integral to our business performance goals. Our core principles include:

- Compliance with all applicable regulations;
- Visible leadership and accountability at all levels;
- Integration of environment and health and safety in business decisions; and
- Continuous improvement in our performance.

> Responsible Environmental Steward

Hydro One integrates environmental considerations into all decision-making and business planning processes. During the past year, Hydro One continued to develop and implement its Environmental Management System (EMS) consistent with the stringent requirements of ISO 14001.

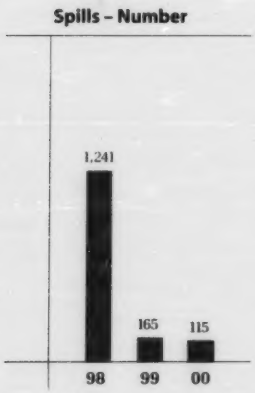
In May 2000, Hydro One issued a comprehensive environmental policy and communicated it throughout the Company. We then conducted workshops at all levels to identify activities, products and services that could affect the environment. We examined the effectiveness of our current controls and developed action plans where needed.

At the same time, we continued our land assessment and remediation (LAR), spill/leak prevention and waste management programs. We initiated a new water well testing and control standard. We also participated in both the development of environmental labelling and disclosure procedures with the Ministry of Energy, Science and Technology (part of the electricity industry restructuring process); and the Canadian Electricity Association's Environmental Commitment and Responsibility Program, an industry-wide effort to continuously improve environmental performance.

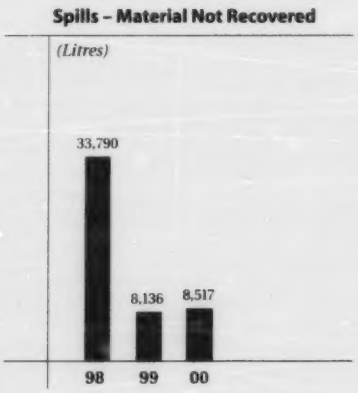
The past year also saw completion of many Class Environmental Assessments (EA), used by Hydro One to secure *Environmental Assessment Act* approvals for transmission projects.

> Focused on Employee Health and Safety

Although Hydro One has strict policies in place to promote workplace safety, in 2000 we experienced our first employee fatality since 1994. An experienced and highly-



The number of spills declined from 1999 and was considerably less than 1998, when the January ice storm caused an unprecedented number of equipment failures.



Spill recovery success is influenced by many factors, including the number of incidents, type and quantity of incidents, type and quantity of material released as well as site features.

Health and Safety

skilled construction line journeyperson was fatally injured while working on transmission tower refurbishment. The employee was properly outfitted and was following all appropriate safety procedures. We have made changes to work procedures to prevent similar accidents.

During the year, we continued to reduce the number of lost-time accidents and those requiring medical attention. We have also improved the safety management system by developing a new Work Protection Code and new safety rules.

Because the actions of supervisors are key to improving performance, Hydro One has integrated health and safety into First-Line Manager training. Over the course of the year, 350 First-Line Managers participated in this new and rigorous training. Other initiatives taken in 2000 were the inclusion of safety performance in management and union incentive pay plans and the upgrading of work process inspections.

> Committed to Community Safety

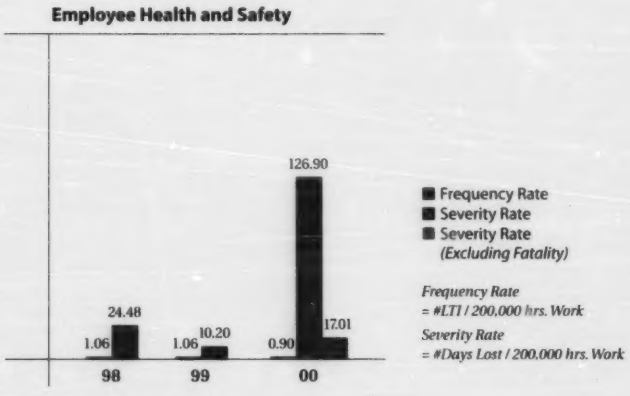
Hydro One's transmission and distribution system must, like any electricity system, be treated with respect due to the inherent hazard of electricity. Although our commitment to safety is strong, occasionally members of the public make inadvertent contact with our lines or station facilities.

There were seven public fatalities associated with Hydro One property in 2000. Four involved contact with Hydro One electrical conductors and three were due to motor vehicle accidents.

As part of our ongoing efforts to minimize such occurrences, Hydro One initiated a comprehensive advertising campaign in 2000 to increase electrical safety awareness across Ontario. We also worked to enhance the profile of public safety through dedicated partnerships with organizations such as the Ontario Provincial Police and by implementing a Community Citizenship Program with community safety as the main focus.

> For More Information

Hydro One's *Environment, Health and Safety Report* provides further details about our environmental performance and health and safety initiatives.



Hydro One's accident frequency rate improved slightly in 2000. However, the accident severity rate increased dramatically, reflecting the Company's first employee fatality since 1994.

Hydro One's Mike Della Rossa presents a $25,000 cheque to OPP Deputy Commissioner Dave Wall in support of the Bearhug Band public safety program.

25 Management's Discussion and Analysis
42 Management's Report
43 Auditors' Report
44 Consolidated Financial Statements
48 Notes to Consolidated Financial Statements
70 Five-Year Summary of Financial and Operating Statistics
72 Board of Directors
74 Board Committees
75 Senior Officers of the Company and Operating Subsidiaries
76 Corporate Information

Financial *review*

Our Company, together with its subsidiaries, owns and operates one of the largest electricity high-voltage transmission systems and low-voltage distribution systems in North America. We acquired the transmission, distribution and energy services businesses of Ontario Hydro on April 1, 1999, as part of the major restructuring of Ontario's electricity industry.

Restructuring and deregulation of the electricity industry has been taking place throughout North America over the past few years. The industry is moving toward more competitive market models that are intended to encourage increased responsiveness to customers and market conditions. In Ontario, the migration to an open market was initiated more than four years ago and has involved extensive study and facilitating legislation. Other actions have also been taken by the Province of Ontario (the Province), including the establishment of the Independent Electricity Market Operator (IMO) and a broadened mandate for the Ontario Energy Board (OEB), to ensure that this evolution proceeds in an orderly manner.

Transmission

Our transmission business owns and operates approximately $6.5 billion of assets, comprised primarily of Ontario's high-voltage transmission system. During 2000, 146.9 terawatt hours (TWh) of electricity were transmitted through our 28,500 kilometre network to 53 municipal electricity utilities and 66 large directly connected industrial companies, and to our own distribution system. We also own and operate 17 facilities that connect our transmission system with systems in neighbouring provinces and U.S. states.

Distribution *(including retail)*

Our distribution business owns and operates approximately $3.4 billion of assets, comprised primarily of a 113,900 kilometre low-voltage distribution network. During 2000, 17.6 TWh of electricity were transmitted through the distribution network to 957,000 customers located in small and medium-sized municipalities and in rural, northern and remote areas of Ontario. This business also serves 38 large industrial customers and 124 municipal electricity utilities that are not connected directly to our transmission system. As part of our growth strategy, we entered into agreements to purchase 84 of the 124 municipal electricity utilities connected to our distribution system. In 2000, we completed the acquisition and integration of 16 of these utilities. In 2001, we expect to complete the acquisition of the remaining 68 distribution-connected utilities. We also acquired one municipal electricity utility in 1999. These acquisitions, as well as three that are directly connected to our transmission system, will result in the addition of approximately 240,000 customers and $350 million of distribution fixed assets.

We also operate a generation and distribution system in 20 remote communities across northern Ontario that are not connected to Ontario's electricity grid. These facilities are owned either by us or by the Ontario Electricity Financial Corporation (OEFC).

Other

Other businesses include energy services, power procurement and telecom. In prior years, these businesses were included with distribution (including retail). Energy services

In 2000, more than 300 senior Hydro One staff participated in the Transformation Through Leadership program. We know we need to develop a more commercial culture and it is programs like this that are making it happen at Hydro One. I am particularly proud that we have received international recognition for our work in this area, confirming that we are on the right track.

ELEANOR CLITHEROE

President and
Chief Executive Officer

Hydro One Inc.

Chair

Hydro One Subsidiaries

One of the things we can offer at this stage, because Hydro One Telecom is still a small company, is that we are very customer-oriented. Every customer is extremely important to us – they're not one of thousands, they're one of a handful and that is reflected in the attention that they receive.

JOAN PRIOR

Executive Vice President,
General Counsel and Secretary

Hydro One Inc.

President and Chief Executive Officer
Hydro One Telecom Inc.

offers business assistance in establishing energy procurement strategies, energy tracking and bill management programs, as well as energy-efficient equipment installation and financing. As the electricity market opens for competition, our current residential offering of communication and home improvement services will be expanded to include energy. Our power procurement business manages power acquisition for the distribution business and will provide settlement services to purchase power from the IMO-controlled electricity market. Our emerging telecom business markets dark and lit fibre-optic capacity to large commercial customers and major carriers. This business also markets co-location space on our microwave towers to wireless service providers.

REGULATION

Our transmission and distribution businesses completed their first full year of regulation under the OEB in 2000. The OEB has the authority under the *Ontario Energy Board Act, 1998* to approve or fix rates for these businesses; the power to provide continued rate protection for rural and remote electricity consumers; and the responsibility for ensuring that distribution companies fulfill obligations to connect and service customers. The OEB issues rate orders that establish rates for the transmission and distribution businesses. The rates are designed to permit these regulated businesses to recover their approved costs and to earn a specified rate of return.

Rate setting is shifting from the traditional cost of service approach to performance-based regulation (PBR). Under PBR, regulated utilities are encouraged to improve operating efficiency through the use of economic incentives to meet or exceed performance targets. Efficiency savings beyond those required by the regulator are shared between the utility and its customers. PBR is also cost-effective, as fewer regulatory reviews are generally required.

Transitional Rate Orders for 1999 and 2000

In 1999, the OEB issued transitional rate orders covering 1999 and 2000 for the transmission and distribution businesses based on a cost of service application that provided for an annual rate of return on average common equity of 9.35%. This rate was adjusted by the OEB to 9.88% in 2000 to reflect higher forecasted interest rates. Average common equity allocated to these businesses, for regulatory purposes, totals approximately $2.9 billion. Because customers pay "bundled" rates, which aggregate the generation, transmission, distribution and other charges for the provision of electricity, customer revenues are collected, pooled and allocated to the successor companies of Ontario Hydro. The transitional rate orders form the basis of revenue allocation to our Company.

The transitional rate orders, which otherwise expire on March 31, 2001, were intended to terminate effective with Open Access. Open Access refers to the introduction of the competitive wholesale and retail electricity markets in Ontario. The Province will determine the date that Open Access will begin. Given the anticipated delay in market opening beyond March 31, 2001, the OEB has entered into discussions with distribution utilities, including our Company, regarding the extension of licences and the transitional rate orders.

Applications for Rates following Open Access

Transmission

The OEB has approved unbundled transmission rates that will apply following Open Access. Although these rates are not based on a PBR framework, they have been designed to yield an approved rate of return of 9.88%, based on deemed average common equity of $2.1 billion. We are currently in the process of developing a PBR rate proposal for later submission to the OEB.

Distribution

The OEB has defined the first-generation PBR framework for distribution utilities in its *Electricity Distribution Rate Handbook*. This framework will establish unbundled distribution rates for the period commencing with Open Access. It includes mechanisms to address productivity, growth, transition and extraordinary costs. The application of these mechanisms will evolve during the first rate period. While the framework also includes a provision to enable excess earnings to be shared between the distributor and its customers, this provision will not be incorporated during the first-generation PBR period. We submitted our amended distribution rate application under this first-generation PBR framework on January 19, 2001.

Our rate application proposes that the increase in the average total bill for retail customers be limited to 3% at Open Access and a further 3% on each of March 1, 2002 and March 1, 2003, based on an assumed increase in the cost of power over the 2000 rate. The total bill for retail customers comprises the competitive energy charge, transmission costs, distribution charge, system control expenses and debt retirement charges incurred primarily as a result of investments by the former Ontario Hydro. The non-distribution costs are passed through to the customer in our capacity as billing agent.

Based on our proposed 3% increase, our rate request for the first-generation PBR period is below the distribution component of revenues based on current rates. This reduction will help our customers better manage their total electricity costs when the market opens. We are developing a plan to address this revenue reduction through the balance of the transition period to Open Access. For the subsequent distribution rate period, we will advance a proposal that reflects our actual ongoing revenue requirement and program needs, including amounts that are not being fully recovered during this transition period.

Rate applications for acquired municipal electricity utilities will continue to be filed separately from the remainder of our distribution business. By the end of 2000, 15 applications had been filed under the same OEB-approved PBR framework that applies to our core distribution business. These applications are expected to be processed by the OEB during 2001.

Remote Communities

We are also pursuing the advantages of a PBR mechanism for our generation and distribution business which services remote communities across northern Ontario. This business will not be part of the competitive market and is not driven by the impetus of Open Access to unbundle its rates. Current rates have been designed on a cost-recovery basis and will continue to apply until a proposal is put forward to the OEB.

At Hydro One, we're on track with our vision of being a leading energy delivery player in this part of the continent. This year, we'll be looking to balance our success in 2000 on the distribution side with more growth in the transmission business.

ROD TAYLOR

Executive Vice President, Planning and Development

Hydro One Inc.

President and Chief Executive Officer

Hydro One Network Services Inc.

In 2000, we issued Hydro One's first debt offering of $1 billion, Canada's second largest corporate offering ever. We also obtained financing at competitive rates, and our bonds are viewed as being among the best corporate credit in Canada today. In 2001 we will continue to provide effective financial management to allow Hydro One to take advantage of market opportunities.

MALEN NG

Executive Vice President,
Chief Financial Officer

Hydro One Inc.

President and Chief Executive Officer
Hydro One Networks Inc.

RESULTS OF OPERATIONS

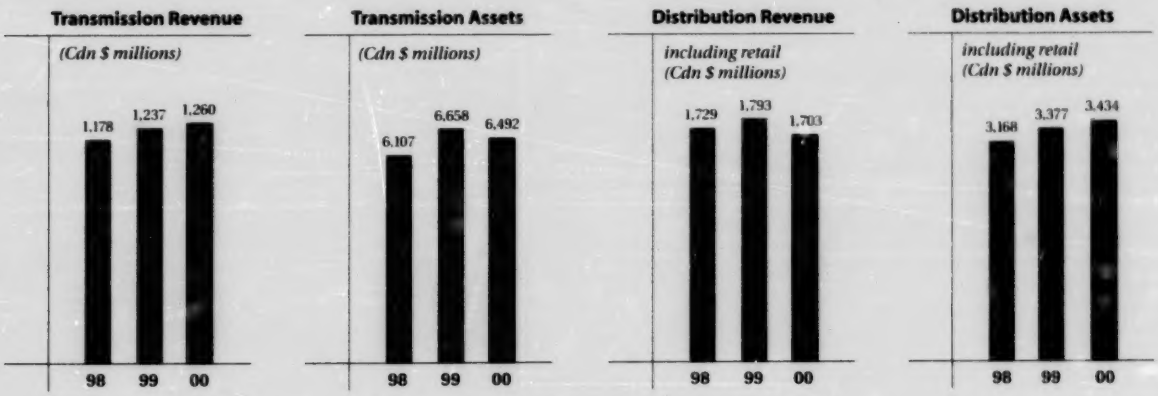
The Consolidated Financial Statements include the results of operations and financial position for periods prior to the acquisition date of April 1, 1999, when our business was conducted by Ontario Hydro. The historical results may have been different had the operations been conducted as a stand-alone corporation, rather than as a business unit of Ontario Hydro. Results for the period beginning April 1, 1999 reflect a new regulatory system and capital structure (see Note 3 to the Consolidated Financial Statements).

Net Income

Net income increased by $3 million over 1999 to $378 million in 2000. This increase was primarily due to a lower provision for payments in lieu of corporate income taxes of $43 million from deductions recognized in the current year for tax purposes but in different periods for accounting purposes, primarily related to the staff reduction program. The increase in the OEB-approved rate of return contributed a further $15 million to the increase in net income. These increases were partially offset by a lower contribution from the retail sale of electricity of $33 million and the impact of the gain of $22 million, after payments in lieu of corporate income taxes, on the sale in 1999 of our investment in Ontario Quinta A.V.V. (Ontario Quinta).

Net income of $375 million in 1999 increased by $105 million, after excluding a credit of $204 million to results of operations in 1998 related to the revaluation of the deferred pension asset. This increase was primarily due to a reduction of approximately $111 million in the costs of the distribution (including retail) business, which resulted from the restructuring of Ontario Hydro and the application of our transitional rate order. The net gain of $22 million on the sale of Ontario Quinta further contributed to the increase in net income. These increases were partially offset by a gain of $30 million in 1998 on the sale of surplus land.

Net income for our regulated transmission and distribution businesses was in line with the annual rate of return



of 9.88% in 2000 and 9.35% in 1999 provided for in our transitional rate orders. These rates of return are based on average common equity of approximately $2.9 billion that is deemed, for regulatory purposes, to be allocated to these businesses.

Revenues

Transmission

Transmission revenues increased by $23 million, or 2% over 1999, to $1,260 million. Revenues increased by $19 million as a result of the increase in the allowed rate of return of 9.88% as approved by the OEB, compared with 9.35% in 1999. The remaining increase in revenue was primarily attributable to an increase in services provided to the other successor corporations of Ontario Hydro.

In 1999, transmission revenues increased by $59 million, or 5% over 1998, to $1,237 million. Revenues increased by $67 million due to higher allowed costs provided for under the transitional rate order approved by the OEB. Revenues further increased by $26 million due to the inclusion of sales of services to the other successor corporations of Ontario Hydro effective April 1, 1999. These sales were partially offset by a $12 million reduction in demand for marketing and sales services related to the disposition of surplus assets to third parties. These increases in revenue were partially offset by the impact of a $30 million gain on the sale of surplus land in 1998.

Distribution (including retail)

Distribution (including retail) revenues declined by $90 million, or 5% over 1999, to $1,703 million. Lower revenue of $44 million was attributable to a reduction in allowed costs provided for under the distribution transitional rate order for 2000. In addition, retail revenues declined by $46 million. Of the reduction in retail distribution revenues, $41 million was due to a reduction in the demand for electricity and $16 million was due to the annexation of some of our service territory to a number of municipal electricity utilities in prior years. The effect of these reductions on retail distribution revenue was partially offset by a reduction in line losses of $11 million.

In 1999, distribution (including retail) revenues increased by $64 million, or 4% over 1998, to $1,793 million. Revenues increased by $83 million due to higher allowed costs provided for under the distribution transitional rate order for 1999. Revenue also increased by $33 million due to the inclusion of sales of services to retail customers, other utilities and other Ontario Hydro successor corporations. The impact of these increases was partially mitigated by a $52 million decline in revenue from our retail distribution business. Within retail, a $102 million reduction in revenues through annexations and a $17 million reduction in rates, primarily due to a shift in the mix of rate groups, was partially offset by a $67 million increase in the demand for electricity from the remaining customer base. The ability of municipalities to annex areas previously served by us ceased as of April 1, 1999 (see Note 11 to the Consolidated Financial Statements).

Other

Other revenues declined by $63 million, or 66% over 1999, to $32 million in 2000 and by $46 million, or 33% over 1998, to $95 million in 1999. Other revenues for 1999 and 1998 were primarily derived from the activities of our subsidiary, Ontario Hydro International Inc. (OHII). The operations of OHII are being wound up and, as part of this strategy, OHII sold its main operating asset, its investment in Ontario Quinta, on September 15, 1999. The reduction in revenue from OHII accounted for a reduction in other revenue of $72 million in 2000 compared with 1999 and by $52 million in 1999 compared with 1998. Excluding the impact from OHII, other segment revenue increased by $9 million in 2000 and by $6 million in 1999 compared to 1998 due to the launch of new telecom and energy services.

Costs

Operation, Maintenance and Administration

Operation, maintenance and administration (OM&A) costs are comprised primarily of labour, material, equipment and purchased services in support of the transmission and distribution system. Such costs are primarily aligned to sustaining, operations, support and recoverable work programs. In addition, OM&A includes property taxes which are paid to municipalities and the Province on our lines, stations and buildings located throughout Ontario and payments in lieu of capital taxes which are paid to the OEFC. Total OM&A declined by $7 million, or 1% over 1999, to $856 million in 2000 and increased by $140 million, or 19% over 1998, to $863 million in 1999 due to the factors discussed below.

Transmission

Transmission OM&A increased by $10 million, or 2% over 1999 levels, to $433 million in 2000. Expenditures related to sustaining, operations and support work programs increased by $6 million to $279 million. Costs incurred to sustain the transmission system, including preventive and corrective maintenance on transformer stations, transmission lines and telecommunications equipment, increased by $10 million. Higher costs for telecommunications and line work were partially offset by lower planning and engineering costs.

Our transmission and distribution businesses completed their first full year of regulation in 2000. Considerable progress was made by Hydro One in conjunction with our Regulator, the Ontario Energy Board, in establishing processes for market opening and the regulatory framework for Ontario's electricity industry. We continue to value our positive regulatory relationships.

MIKE BERMON

Senior Vice President, Chief Regulatory Officer

Hydro One Networks Inc.

Increased telecommunication expenditures are required to maintain the aging analog microwave radio system. The increase in sustaining work program costs was partially offset by a reduction of $4 million in centralized support costs, which was primarily attributable to the staff reduction program. The cost to run our Transmission Operations Management Centre and Transmission Operating Centres, which monitor the wires system and provide a field operating interface with stakeholders, was consistent with the prior year. Recoverable work programs, which represent costs incurred to provide services primarily to the other successor corporations of Ontario Hydro, increased by $4 million to $68 million, due to an increase in services provided. Transmission OM&A associated with property taxes and payments in lieu of capital taxes amounted to $86 million, consistent with the prior year.

Transmission OM&A for 1999 totalled $423 million, an increase of $74 million, or 21%, over 1998. Expenditures associated with sustaining, operations and support work programs increased by $17 million to $273 million, primarily as a result of environmental management, vegetation clearing and telecommunications activities. Included in these work program costs was a net charge of $5 million, which consisted of a $33 million charge associated with the staff reduction program, partially offset by the reversal of an earlier staff reduction provision of $6 million and a provision for real estate costs of $22 million. Costs incurred to support recoverable work programs in 1999 increased by $25 million over 1998 to $64 million, primarily due to the provision of services to the other Ontario Hydro successor corporations commencing with the restructuring of Ontario Hydro. Property taxes and payments in lieu of capital taxes amounted to $86 million in 1999, an increase of $32 million. This was the result of new levies and the new requirement to make payments in lieu of capital taxes, effective April 1, 1999.

Distribution (including retail)

Distribution (including retail) OM&A of $388 million increased by $6 million, or 2%, over spending levels in 1999. Incremental costs of $10 million were incurred in support of the acquisition of municipal electricity utilities. In addition, OM&A associated with property taxes and payments in lieu of capital taxes increased by $4 million, to $13 million. Expenditures related to sustaining, operations and support work programs declined by $3 million to $346 million. We experienced a reduction of $5 million in centralized support program costs, which was primarily related to the staff reduction program. This reduction was partially offset by an increase of $2 million in operating costs associated with customer services, reflecting our new obligations as a distributor in the emerging competitive electricity market. Costs incurred to sustain the distribution system, including our remote system, which are primarily related to customer trouble calls to restore power, vegetation management and line and station maintenance work, were consistent with 1999. Lower costs for line maintenance and vegetation management were offset by higher costs to operate our remote system, primarily from rising fuel prices. Costs incurred to support recoverable work programs declined by $5 million to $19 million due to a change in the mix of services provided.

Distribution (including retail) OM&A for 1999 totalled $382 million, an increase of $64 million, or 20%, over 1998 levels. Expenditures associated with sustaining, operations and support work programs increased by $32 million to $349 million in 1999. Increased costs of $54 million,

primarily as a result of customer trouble call activity, vegetation management and the start-up of a pilot project to enhance outage management and line and station maintenance, were substantially offset by $41 million in costs incurred in 1998 related to the January 1998 ice storm. In addition, a net charge of $19 million was recorded which consisted of a $27 million charge associated with the staff reduction program, partially offset by the reversal of an earlier staff reduction provision of $8 million. Recoverable work program costs of $24 million were incurred to provide services to retail customers, other utilities and other Ontario Hydro successor corporations. Property taxes and payments in lieu of capital taxes amounted to $9 million in 1999, an increase of $8 million. This was the result of new levies and the new requirement to make payments in lieu of capital taxes, effective April 1, 1999.

Staff Reduction Program

In November 1999, our Board of Directors approved a staff reduction program intended to reduce cost levels. Although most of the costs associated with the staff reduction program were funded from the pension plan surplus, we recorded a provision in 1999 of $60 million, primarily related to cash incentives and supplementary pension benefits that could not be charged to the pension surplus. The provision also included the estimated cost of limited targeted buy-outs and involuntary severance. With approximately 1,400 employees accepting early retirement, the staff reduction program was substantially completed during 2000 and costs of $53 million were charged to the provision. In addition, we determined that $5 million of the provision related to supplementary pension benefits and involuntary severance would not be used and reversed this amount as a credit to the results of operations in the current year. The program reduced the pension surplus, for funding purposes, by $270 million.

In 1999, we re-evaluated the need for some provisions previously recognized by Ontario Hydro and assumed by our Company on April 1, 1999. A remaining provision of $14 million associated with an involuntary staff reduction program originally recognized by Ontario Hydro in 1997 was reversed as a credit to the results of operations in 1999. In addition, due to a change in market and other business conditions, a real estate provision of $22 million originally recorded by Ontario Hydro in 1993 was reversed as a credit to the results of operations in 1999.

Other

Other OM&A declined by $23 million, or 40%, to $35 million in 2000 and increased by $2 million, or 4%, to $58 million in 1999. Other OM&A for 2000, 1999 and 1998 related to the activities of OHII were nil, $31 million and $44 million, respectively. Excluding the impact from OHII, other OM&A increased by $8 million in 2000 and by $15 million in 1999 compared with the previous year. The increase in 2000 was primarily in support of our new telecom and energy services. The increase in 1999 was primarily related to the establishment of our holding company.

Purchased Power

Purchased power costs declined by $73 million, or 8%, compared with 1999 to $866 million. Approximately $43 million of the reduction mirrors the decline in retail distribution revenue from the demand for electricity and the annexations by municipal electricity utilities of areas that we previously served. The decline associated with our divestiture of

Hydro One is making an exciting move into a new business area – marketing our skills and capabilities in the "utility business process backroom". We plan to offer services to other utilities, both inside and outside Ontario, for billing, customer care, and supply chain management. This is a strategic growth area for the Company.

KATHRYN BEATON

Chief Information Officer

Hydro One Inc.

President and Chief Executive Officer

Hydro One Markets Inc.

The financial strength of Hydro One is of utmost importance. The Company has successfully prepared itself to enter an open electricity marketplace with the financial capability to grow. The same financial prudence that guided our growth in 2000 will continue throughout 2001.

KEN HARTWICK

Senior Vice President, Finance

Hydro One Inc.

Ontario Quinta amounted to $37 million. These reductions were partially offset by an increase of $7 million in costs to support our new business ventures.

In 1999, purchased power costs declined by $226 million, or 19%, compared with 1998 to $939 million. Approximately $190 million of this reduction reflected a lower cost for the energy we delivered. Purchased power costs decreased by $56 million due to the annexation of some of our service territory, partially offset by a $48 million increase in purchases due to higher sales to our remaining customer base. Purchased power costs further declined by $28 million as a result of the sale of our investment in Ontario Quinta in September 1999.

Depreciation and Amortization

Depreciation and amortization expense increased by $6 million, or 2% over 1999, to $348 million in 2000, and by $42 million, or 14% over 1998, to $342 million in 1999. In 2000, an increase in depreciation expense of $16 million due to higher depreciation and removal charges associated with our expanded capital program was partially offset by lower amortization expense of $10 million associated with the regulatory assets. In 1999, increased amortization of $52 million was partially offset by lower depreciation expense of $10 million, which was attributable to a lengthening of service lives and a gain on the minor sale of real estate.

Ontario Hydro adopted accrual accounting for its employee future benefits other than pension in 1997, and in 1998 changed the discount rate used to measure these liabilities from a long-term average rate to a market-based interest rate in anticipation of new accounting recommendations from the Canadian Institute of Chartered Accountants. The OEB approved a regulatory asset to provide for the recovery of the past service cost associated with these liabilities over a 10-year period on a straight-line basis. The amortization for 2000 reflects a full-year expense of $42 million compared with nine months in 1999 and nil in 1998. Also in 1999, the OEB approved the full recovery in that year of certain costs charged to operations by Ontario Hydro in 1997. As a result, amortization related to this regulatory asset was $20 million in 1999 and nil in each of 2000 and 1998.

Transitional Cost Adjustment

The transitional cost adjustment was a one-time charge that amounted to $55 million for the three months ended March 31, 1999. This charge represented the difference between allowed costs specified in the transitional rate orders approved by the OEB and costs that were allowed under the *Power Corporation Act*.

Provincial Debt Guarantee Fee

The Province does not guarantee our debt and consequently we did not incur a debt guarantee fee in 2000. Prior to April 1, 1999, however, the Province did guarantee the debt of Ontario Hydro, which was partially secured by assets that we acquired.

Deferred Pension Asset

In accordance with the provisions of the *Electricity Act, 1998*, Ontario Hydro recorded an increase in the value of the deferred pension asset, with a corresponding credit of $204 million to 1998 results of operations. Specifically, the provisions of the *Electricity Act, 1998* allow our Company to reduce employer contributions to the pension fund to the extent permitted under the *Pension Benefits Act* when the plan has a surplus.

Gain on Sale of Investment

On September 15, 1999, our subsidiary, OHII, sold its 25% equity interest in Ontario Quinta. At the time of sale, Ontario Quinta held a 60% interest in Luz del Sur S.A.A., an electricity distribution company serving southern Lima, Peru, and a 64% interest in Tecsur S.A.A., a utility maintenance and construction company also operating in Peru. We realized a gain of $32 million before payments in lieu of corporate income taxes on this sale in 1999.

Financing Charges

Financing charges declined by $41 million, or 11% over 1999, to $340 million in 2000 and by $178 million, or 32%, to $381 million in 1999. These decreases primarily reflect a reduction of $28 million in 2000 and $131 million in 1999 resulting from lower average levels of debt, and a reduction of $10 million in 2000 and $47 million in 1999 from lower average interest rates. The lower levels of debt reflect the new capital and debt structure established on April 1, 1999, in conjunction with the acquisition of our transmission, distribution and energy services businesses. Prior to April 1, 1999, financing charges represented the interest and expenses associated with the allocated portion of Ontario Hydro's debt.

Provision for Payments in Lieu of Corporate Income Taxes

The provision for payments in lieu of corporate income taxes increased by $13 million, or 7% over 1999, to $207 million. We have been obligated under the *Electricity Act, 1998* to make these payments in lieu of corporate income taxes to OEFC based on our results of operations since April 1, 1999. As a result, the provision for 2000 reflects an expense for the full year as compared to nine months in 1999 and no expense in 1998. On a full year basis, the lower provision for 2000 reflects a lower level of income and an increase in deductions, primarily for the staff reduction program. The charge for the staff reduction program was recognized for accounting purposes in 1999, but taken as a deduction for tax purposes in 2000 when the related cash payments were made.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity and Capital Resource Requirements

Capital Expenditures

Capital expenditures are made to safeguard the long-term reliability of our asset base, which is geographically dispersed and exposed to weather conditions. Investments are also required to expand our market, pursue our objective of reducing costs and to prepare for Open Access. Total capital expenditures were $469 million in 2000, compared with $529 million in 1999 and $394 million in 1998.

Capital expenditures for the transmission business were $280 million in 2000, representing a 14% decrease over the 1999 level of $327 million but a significant increase over 1998 capital expenditures of $171 million. The change in the level of expenditures since 1998 primarily reflects infrastructure and facilities programs, including the ongoing planned replacement of our old protection and control microwave radio system, and increased investments made in expansion programs during 1999.

Capital expenditures of $183 million on our transmission stations, lines, equipment and telecommunications refurbishment were lower than the 1999 level of $193 million. Similar expenditures in 1998 amounted to $79 million. End-of-life replacement of transmission station equipment and transmission lines, poles and towers located throughout the province amounted to $133 million. Capital expenditures on comparable work in 1999 and 1998 amounted to $142 million and $59 million, respectively. Excluding transportation and work equipment, end-of-life replacement spending was maintained at the 1999 level, which had been increased over 1998 to address asset condition work deferred by Ontario Hydro. Reinvestment in transportation and work equipment during 1999 enabled a lower level of spending in the current year. Capital expenditures on telecommunication equipment, primarily related to the replacement of our aging analog protection and control microwave radio system with fibre-optic lines, amounted to $50 million in

Capital Expenditures

Transmission *(Cdn $ millions)* *Year ended December 31, 2000*	2000	1999	1998
Sustainment	183	193	79
Expansion	64	101	67
Operations support and efficiency enhancement	33	33	25
	280	327	171

Distribution *(including retail) (Cdn $ millions)* *Year ended December 31, 2000*	2000	1999	1998
Sustainment	34	78	105
Expansion	79	78	49
Operations support and efficiency enhancement	39	27	34
MEU acquisitions	23	3	–
	175	186	188

The challenges and opportunities of 2000 – downsizing, regulatory compliance, mergers and acquisitions, our debt prospectus – resulted in enormous accomplishments. But we can't stop to catch our breath in 2001, as we continue to develop and reinforce the proper governance and legal framework for a commercial company in a new marketplace.

LAURA FORMUSA

General Counsel and Secretary

Hydro One Networks Inc.

2000 and $51 million in 1999. In 1999, the first phase of the replacement was completed, involving the replacement of the analog system in the Toronto core area. In 2000, the second phase was implemented, which involved the replacement of the analog system at 14 sites in southern Ontario. Telecommunication expenditures of $20 million in 1998 reflected preliminary work on the microwave radio replacement project and ongoing refurbishment activity.

Investments in expansion programs to meet the growing demands of new and existing customers amounted to $64 million in 2000, $101 million in 1999 and $67 million in 1998. During 1999, the completion of international negotiations enabled work to commence on the installation of three phase-shifting transformers and an autotransformer at the interconnection with the State of Michigan. This equipment will increase our import capacity by 500 megawatts (MW) and export capacity by 1,000 MW. Expenditures related to this project in 1999 amounted to $23 million and were primarily for design, site preparation and a significant portion of the switchyard electrical, control metering and relaying work. In 2000, we spent $11 million to complete the installation and begin the commissioning of the first phase-shifter. We also completed the construction of a dedicated transmission service to the auto industry in the Windsor area at a cost of $9 million in 2000 and $17 million in 1999. Also in 1998 and 1999, a number of network reinforcement projects were undertaken in response to the January 1998 ice storm. These projects were completed by the end of 1999.

Capital expenditures to support operations, increase efficiency and reduce costs amounted to $33 million in each of 2000 and 1999, and $25 million 1998. In 2000, these projects included the implementation of a new network management system. This system will enhance our ability to monitor and manage our transmission assets and to maximize our transmission capability and utilization. In addition, the construction of the Transmission Outage Management Centre which started in the previous year was completed. In 1999, we also consolidated a number of dispersed operating centres and upgraded the supervisory control and data acquisition equipment. Expenditures in 1998 were primarily related to development costs for our work management and financial systems.

Capital expenditures for the distribution business were $175 million in 2000, compared with $186 million and $188 million in 1999 and 1998, respectively. The majority of capital expenditures for this business are driven by customer demand and the condition of our assets, and also include some infrastructure support work. In addition, we spent $23 million to acquire 16 municipal electricity utilities in 2000. Acquisition-related expenditures amounted to $3 million in 1999 and nil in 1998.

Customer-demand-driven capital expenditures amounted to $79 million in 2000 compared with $78 million in 1999 and $49 million in 1998, and included new connections, customer load and our joint-use and relocation program. Joint-use costs are incurred to support upgrade requirements of third-party users of our equipment and are carried out under various cost-sharing arrangements.

Capital expenditures incurred to sustain the existing asset base amounted to $34 million in 2000, compared with $78 million and $105 million in 1999 and 1998, respectively. Expenditures for 1998 included approximately $49 million related to the January 1998 ice storm. In 1999, we enhanced our wood pole replacement program in response to an asset condition study. We replaced approximately five times as many poles in 1999 as we did in either 2000 or 1998. In addition, higher investments in

transportation and work equipment were made during 1999 than in 2000 or 1998.

Expenditures to support operations and enhance efficiency and reduce costs amounted to $39 million in 2000, $27 million in 1999 and $34 million in 1998. Projects for 2000 were focused on preparation of our systems and processes for Open Access. Expenditures in 1999 were primarily incurred to support a pilot project to improve outage management and various projects to integrate supporting information systems. In 1998, expenditures were primarily for upgrades to our customer service system.

Capital expenditures for our other operations amounted to $14 million in 2000, compared with $16 million in 1999 and $35 million in 1998. After excluding capital spending in support of OHII, the operations of which were substantially wound down in 1999, capital expenditures amounted to $14 million, $10 million and $7 million in each of the years 2000, 1999 and 1998, respectively. The year-over-year increases were made in support of our new telecom and energy services businesses.

Capital expenditures are budgeted at about $1,160 million in 2001. Of this amount, approximately $500 million is required to close the outstanding acquisition agreements with 71 municipal electricity utilities (see Note 4 to the Consolidated Financial Statements).

The budget for our transmission business in 2001 is $390 million, an increase of $110 million from the level of expenditures in 2000. In 2001, we plan to commission the Ontario-Michigan interconnect and begin construction of an interconnection project with Hydro-Québec. These projects are important steps in fulfilling our commitment to increase import capacity by 2000 MW within three years of Open Access. We also plan to continue with the fibre-optic replacement of the existing microwave radio system in sections of southern, eastern and northeastern Ontario. Expenditures will also be made to further rationalize our Transmission Operating Centres. We also plan to increase our capital investments in our transmission stations.

Excluding our acquisition program, capital expenditures for our distribution business are budgeted at $245 million, representing an increase of $93 million from 2000 expenditures. We are planning to extend the end-of-life pole replacement program and begin development of a distribution outage management system. Planned upgrades to our financial systems will further increase our objective of enhancing efficiency.

Other capital expenditures are budgeted at $25 million, an increase of $11 million over 2000. This increase is primarily related to the expansion of our fibre-optic communication system in support of our growing telecom business.

Servicing Indebtedness

As at December 31, 2000, we had long-term debt outstanding of $4,446 million, including the current portion, with a current average interest rate of 8.13%. Of this amount, $3,446 million is due to OEFC and $1 billion was issued in connection with our inaugural bond issue on June 1, 2000.

The notes due to OEFC are unsecured, and senior in ranking. These notes bear interest at various rates, with a current weighted-average interest rate of 8.4% per year, and mature between 2001 and 2007. The notes due in 2001 total $474 million. We may, at our option, prepay at any time all or part of the notes.

In connection with the refinancing of maturing notes due to OEFC, we offered and sold debentures in the amount of $1 billion. The debentures were issued in three series:

At Ontario Hydro Energy, we are focusing on rapid growth through customer service and marketing. Every day, our Company is being evaluated by thousands of new customers who have the choice to deal with us – or not. With our new communications and energy offerings, we have increased our customer base by 30% in six months to more than 200,000 customers.

MIKE MILLER

President and Chief Executive Officer

Ontario Hydro Energy Inc.

Connecting with the communities we serve is a priority for Hydro One. As the North American electricity industry evolves, the strength of the partnerships we form with Ontario communities and their local leadership, and with our shareholder will be key to our continued success.

DEB HUTTON

Vice President, Corporate Relations

Hydro One Networks Inc.

$200 million five-year debentures at a coupon rate of 6.94%; $400 million 10-year debentures at a coupon rate of 7.15%; and $400 million 30-year debentures at a coupon rate of 7.35%. The debentures rank equally with the remaining notes due to OEFC.

Outstanding short-term promissory notes as at December 31, 2000 amounted to $130 million, with maturities not exceeding 365 days. The notes bear interest at a weighted-average rate of 5.75%.

Post-acquisition Adjustment

We recorded the purchase of our transmission, distribution and energy services businesses from OEFC at the exchange amount of $8.6 billion, which approximated the book and fair values of the assets acquired and liabilities assumed on April 1, 1999. The actual net amount of assets and liabilities acquired was less than estimates by $122 million. This excess of equity and liabilities over assets has been recorded as an account receivable, pending the outcome of the rate-setting process relating to pension costs and contributions in aid of construction. We anticipate that the $122 million account receivable will be adjusted through shareholder's equity. However, if the OEB determines that pension costs should be included in the revenue requirement on the accrual basis of accounting or confirms that we can recover contributions in aid of construction through rates, the assets acquired on April 1, 1999 would be higher than the exchange amount. In this case, we anticipate a resulting post-acquisition adjustment to increase debt and shareholder's equity in a manner consistent with the original capital structure. At this time, the outcome of the rate-setting process and the impact on debt, equity and other net assets cannot be determined (see Note 3 to the Consolidated Financial Statements).

Payment of Dividends

The preferred shares issued on March 31, 2000, are entitled to a total annual cumulative dividend of $18 million, payable on a quarterly basis. Dividends on our common shares are declared at the sole discretion of our Board of Directors, as recommended by management. Key factors influencing management's recommendation include results of operations, our Company's financial condition, cash requirements and other pertinent factors, such as industry practice and shareholder expectations.

Preferred dividends of $18 million and common dividends of $236 million, including $23 million approved on February 13, 2001, have been declared for the year ended December 31, 2000. For the nine months ended December 31, 1999, $13 million in preferred dividends and $158 million in common dividends were paid to the Province on March 31, 2000 (see Note 16 to the Consolidated Financial Statements).

Payments in Lieu of Corporate Taxes

Under the *Electricity Act, 1998*, we are required to make payments in lieu of corporate taxes to OEFC, commencing April 1, 1999. These payments are calculated in accordance with the rules for computing income and taxable capital and other relevant amounts contained in the *Income Tax Act* (Canada) and the *Corporations Tax Act* (Ontario) as modified by the *Electricity Act, 1998*, and related regulations.

Sources of Liquidity and Capital Resources

Cash Provided from Operations

Net cash provided from operations was $713 million in 2000, compared with $851 million in 1999 and $520 million in 1998. The reduction of $138 million over 1999 primarily reflects higher levels of working capital. Accounts payable and accrued liabilities declined due to cash payments made under the staff reduction program and the resulting reduction in payroll-related liabilities. Lower accounts payable and accrued liabilities were partially offset by a reduction in accounts receivable consistent with lower retail distribution revenue, a decline in inventory levels as a result of our rationalization program, and an increase in the accrual for employee future benefits other than pension.

The increase in net cash provided from operations of $331 million between 1999 and 1998 reflected net income growth in 1999 (after adjusting 1998 income for the revaluation of the deferred pension asset), higher accounts payable and accrued charges as well as higher accrued interest following the initial capitalization of our Company on April 1, 1999. Accounts payable and accrued charges at December 31, 1999 included amounts for power which, prior to the Ontario Hydro reorganization, had been settled between business units immediately. Accounts payable and accrued charges at the end of 1999 also included amounts for payments in lieu of corporate taxes, and the net increase in provisions associated with the staff reduction program and the reversal of certain provisions. These increases were partially offset by the reduction in long-term accounts payable and accrued charges resulting from the operations of OHII being wound up.

Short-term Credit Facilities

On August 18, 2000, we entered into a revolving standby credit facility of $500 million for a 364-day term and $250 million for a five-year term, arranged through a syndicate of financial institutions. This standby facility is used to backstop the issuance of commercial paper. The facility provides for varying rates of interest based on Canadian benchmark rates, including a prime rate and a bankers' acceptance rate. Covenants under the revolving credit facility limit our permissible total debt as a percentage of total capitalization, restrict our ability to sell assets, and impose a negative pledge provision subject to customary exceptions. The indebtedness under this credit facility ranks equally with all other unsecured indebtedness. We also have the ability to increase the size of the 364-day term facility up to $750 million.

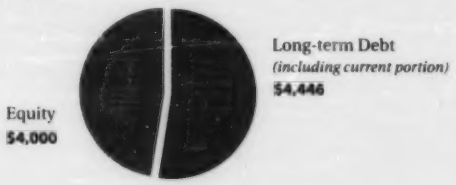
On September 6, 2000, we launched our commercial paper program to manage working capital needs and bridge cash requirements between long-term debt issues, which may include the temporary funding of municipal electricity utility acquisitions. We are authorized to issue up to $1 billion in short-term promissory notes with a term to maturity of less than 365 days.

Debt Capital Markets

We are in the process of establishing our Canadian Medium Term Note (MTN) program with applicable Canadian securities regulators. The size of the MTN shelf is $2.5 billion and is valid for a period of two years. We intend to use the MTN program to meet most of our 2001 and 2002 borrowing requirements, including the funding of our municipal electricity utility acquisitions.

Capital Structure *(Cdn $ millions)*

December 31, 2000



RISK MANAGEMENT

We are implementing an enterprise risk management policy and framework that aim to balance risk while also optimizing returns. The development of a strong risk management culture enables regulatory, strategic, operational and financial risks to be managed and aligned with strategic business objectives.

While our philosophy is that risk management is the responsibility of all employees, the Audit and Finance Committee of our Board of Directors has been mandated to review the risk profile and the status of the internal control framework annually. Our Chief Executive Officer has ultimate accountability for risk management. Our Chief Financial Officer is responsible for the ongoing monitoring and review of the risk profile and practices and works in close association with the senior management team to ensure that the risk management program is an integral part of our business strategy, planning and objectives. The Audit and Finance Committee, the Chief Executive Officer and the Chief Financial Officer are supported by the Chief Risk Officer. This support includes coordinating risk policies and programs, preparing risk assessments and profiles and assisting line and functional managers in fulfilling their responsibilities. Internal Audit is responsible for performing independent reviews of the effectiveness of risk management policies, processes and systems.

Over the next three years, Hydro One Remotes plans to improve bill collection, implement remote fuel measuring to make fuel management more efficient, and improve training of First Nation agents to enhance customer service and environmental performance.

LES HORSWILL

President and Chief Executive Officer

Hydro One Remote Communities Inc.

Market Risk

Market risk refers primarily to the risk of loss that results from changes in interest rates, foreign exchange rates and commodity prices. All of the long-term debt outstanding at December 31, 2000 is denominated in Canadian dollars and bears interest at various rates, with a current weighted-average rate of 8.13%. We are exposed to fluctuations in interest rates as maturing debt is refinanced. However, the effect of higher future interest rates could be partially mitigated should the OEB adjust the approved rates. We are not currently exposed to fluctuations in foreign exchange rates. We may decide in the foreseeable future to issue debt in foreign currency. We could swap any foreign currency denominated debt into Canadian dollars at or about the date of issuance to mitigate foreign exchange rate risk.

A 1% change in interest rates on the long-term debt maturing in 2001 would affect net income by $1.3 million. The same 1% change in rates on debt maturing in 2002 would affect net income by an additional $2.5 million, for a total impact of $3.8 million.

Although we are not currently exposed to commodity risk, the introduction of Open Access will result in increased competitive pressures and some potential risk relating to fluctuations in electricity prices and volumes. Rates for our transmission business are based on projected levels of peak demand. A significant reduction in actual consumption levels from projections could negatively affect the rate of return of this business. In the event of reductions resulting from unusual circumstances, we would apply to the OEB for a rate increase.

While our distribution business faces a similar volume risk, it is not exposed to commodity risk. The OEB has allowed all distributors to pass commodity costs through to customers. Our entry into the competitive retail market will create exposure to price and volume risks, both of which we believe can be mitigated. These risks arise from different prices, volumes and other conditions in supply contracts as compared to prices negotiated with customers and their actual volume requirements. We intend to limit our exposure to commodity price and volume risk in the competitive retail market through contract-matching techniques and risk transfer mechanisms, such as insurance. Overall, we believe that our exposure to commodity risk will be limited.

Credit Risk

Financial assets create a risk that a counter-party will fail to discharge an obligation, causing a financial loss. Currently, there are no significant concentrations of credit risk with respect to any class of financial assets. Our revenue is earned from a broad base of customers consistent with the draft revenue allocation agreement among the successor corporations of Ontario Hydro. As a result, we currently do not earn a significant amount of revenue from any single customer. However, with the introduction of Open Access, we will be required to procure wholesale power on behalf of competitive retailers for resale to their customers. The resulting concentrations of credit risk will be mitigated through the use of various security arrangements, which will be incorporated into our service agreements with these retailers in accordance with the OEB's *Retail Settlements Code.*

In addition, we have not entered into any transactions involving derivative financial instruments. We may decide to enter into such transactions in the future to hedge foreign exchange and interest rate risk. In this case, credit risk will be monitored and minimized through the use of master agreements that incorporate netting provisions. Netting

provisions enable the settlement of derivative financial assets and liabilities with the counter-party on a net basis in the event that the counter-party defaults.

Regulatory Risk

The process of restructuring Ontario's electricity industry and the development of the regulatory framework continues. Over the long term, we anticipate PBR to be positive for all stakeholders. An output-based regulation framework should provide our Company with an opportunity to earn enhanced returns while delivering rates to customers that reflect continuing efficiency improvements and high levels of service. Over the short term, the evolving electricity marketplace exposes us to actions of competitors, suppliers, regulators and government that could affect our financial results.

Revenues from our transmission and distribution businesses depend on approved rates for customers. Transmission rates for the period following Open Access have been approved at a sufficient level to operate our transmission system and to earn a market-based rate of return, currently deemed to be 9.88%. The amended rate application filed for our distribution business contemplates a reduction in distribution revenue. While we will strive to manage the distribution business, on a short-term basis, within the revenue envelope, we may not achieve the market-based rate of return that would otherwise be permitted. For the second-generation PBR period, we will advance a proposal for distribution rates that reflects our actual ongoing revenue requirement and program needs, including amounts that are not being fully recovered under our current rate application.

We expect to file an application with the OEB to recover the market transition costs incurred to align business systems and practices with the requirements of the future competitive electricity market (Market Ready costs). The process and timing for this approval have not been established. After the market opens, the OEB will review issues regarding the timing and mechanisms for the recovery of Market Ready costs and will establish guidelines at that time. Our application will follow these guidelines. The total period and capital transition costs incurred for the transmission and distribution businesses are projected to be more than $80 million upon Open Access. While these expenditures continue to be incurred and deferred with rigorous adherence to the initial criteria for transition costs established by the OEB, the OEB has the discretion to examine and assess the extent to which these Market Ready costs will be fully recovered.

The rate structure also supports the annual level of capital expenditures. Our capital expenditure program is focused on improving asset condition and operational efficiency and achieving our expansion objectives. The *Electricity Distribution Rate Handbook* includes other mechanisms to recover extraordinary expenditures, such as those incurred as a result of severe weather conditions.

Environmental Risk

We manage a number of environmental risks which are primarily related to contaminated land, polychlorinated biphenyls (PCBs), spills and leaks. We have developed specific environmental management programs for these risks, including a program to systematically assess and remediate, if necessary, contaminated land and a program to identify and safely destroy PCB-contaminated equipment. We also have a program to respond to spills and to reduce the amount of insulating oil leaking from equipment. In addition, the nature of our operations requires permits and approvals to be obtained under applicable environmental legislation. Environment-related OM&A expenses and environment-related capital expenditures totalled $40 million in 2000, $49 million in 1999 and $37 million in 1998.

Estimated expenditures for land assessment and remediation are expected to total approximately $95 million over a period of four to nine years. Of this amount, about $75 million relates to the assessment and remediation of contaminants that may have spread from transmission stations, distribution stations and service centres to adjacent properties. This estimate assumes that only off-site contaminants that pose a risk to human health or the environment will be remediated, and that the further spread of off-site contamination will be prevented.

The remaining estimated expenditures related to land assessment and remediation consist of $17 million for remote generating stations and $3 million for generating station switchyards. On September 2, 1997, the Ministry of the Environment issued a binding administrative order against Ontario Hydro that has resulted in these undertakings. It is estimated that these costs will be incurred over four to six years.

The estimates for land assessment and remediation assume that the Ministry of the Environment and, in the case of the remote generating sites, the Federal Department of Indian Affairs and Northern Development and affected Indian bands, will support our approach to assessment and remediation and that existing environmental regulations will not change.

Estimated expenditures for the removal and destruction of PCBs are expected to total approximately $170 million and will be incurred over 20 years. This estimate assumes that existing environmental regulations regarding PCB limits

Our human resources function is being modelled along best-in-class principles. We have centralized to improve synergies and build on scale. Our web site is user friendly and we encourage all staff to use it for transactional items. This frees up our HR consulting staff to provide higher-level support for Hydro One managers. Our goal is to continue adding value while reducing human resources costs.

TOM GOLDIE

Vice President, Human Resources

Hydro One Inc.

will not change and that the timetable for the phase-out and destruction of PCBs will not be accelerated. Based on our recent experience of the cost to inspect and test transformers, we have increased our estimate over 1999.

Transfer of Assets

We are also exposed to financial risk associated with the cost to complete the transfer to our Company of title to assets located on Indian lands in connection with the acquisitions of our operations on April 1, 1999. Transfer of title to these assets did not occur because authorizations originally granted by the Minister of Indian Affairs and Northern Development (Canada) for the construction and operation of these assets could not be transferred without the consent of the Minister and the relevant Indian bands or bodies or, in several cases, because the authorizations had either expired or had never been properly issued. We manage these assets, which are currently owned by OEFC.

We have commenced negotiations with the relevant Indian bands and bodies to obtain the authorizations and consents necessary to complete the transfer of these transmission, distribution and other assets. We cannot predict the total amount that we may have to pay to obtain the required authorizations and consents. We expect to pay more than $850,000 per year, which was the amount previously paid to these Indian bands and bodies by Ontario Hydro and which is the total amount of allowed costs in the transitional rate orders. If, after taking all reasonable steps, we cannot otherwise obtain the authorizations and consents from the Indian bands and bodies, OEFC will continue to hold these assets for an indefinite period of time. Alternatively, we may have to relocate these assets from the Indian lands to other locations at a cost that could be substantial, or, in a limited number of cases, abandon a line and replace it with diesel generation facilities. In such cases, we would apply to the OEB to recover these costs in future rate orders.

Union Negotiations

The substantial majority of our employees are represented by either the Power Workers' Union or the Society of Energy Professionals and as a result, we face financial risks related to our ability to negotiate collective agreements consistent with our rate orders. On December 27, 2000, we reached a one-year settlement with the Society of Energy Professionals. The collective agreement with the Power Workers' Union will expire on March 31, 2001. Negotiations have concluded and we expect that the tentative agreement will be ratified in the short term. We believe that each settlement is well-balanced and reasonable and will enable us to continue to pursue productivity initiatives.

OUTLOOK

The process of restructuring Ontario's electricity industry initiated by the Province will result in the wholesale and retail electricity markets becoming open to competition. Our objective in this changing marketplace is to continue to be Ontario's dominant electricity transmission and distribution company and to expand our unregulated businesses. We will continue to improve overall operational efficiency. We will embrace PBR and will continue to participate in the development of the regulatory and market framework for Ontario's electricity industry. We will also take advantage of our core strengths – including our skilled workforce and financial strength – to pursue selected growth opportunities.

Our immediate focus on growth remains the rationalization of Ontario's distribution sector. To date, we have signed agreements to purchase 88 municipal electricity utilities, representing 240,000 additional customers. Brampton Hydro Corporation is the largest acquisition with approximately 84,000 customers. The opportunity now is to gain regulatory approval and to move quickly to close each transaction. We expect that our carefully planned integration processes will deliver the operational savings enabled by this consolidation effort. Although the pace of further rationalization in Ontario will slow, we will continue to be a leader in this movement and will look to partnerships and other structures that will create value.

The expansion of the transmission system will enhance our growth prospects in both the Canadian and U.S. electricity markets. Between the interconnection project with the State of Michigan and the proposed project with Hydro-Québec, we will increase our import capacity by 1,850 MW and export capacity by 2,350 MW. Significant fragmentation is prevalent in the U.S. transmission market and we are well positioned to participate in the pending transition process. The extension of core transmission and distribution services, including innovations in information technology, to other industry participants will also create additional opportunities for growth.

We retained the Ontario Hydro brand name, a very valuable asset in serving the retail market. Competition is renewing the potential for this market and we are leveraging the Ontario Hydro name in our expanded service offerings to residential, commercial and industry customers. Our current offering of Onsource long distance services, home improvement services, water heaters and other elements will be bundled with electricity once this market opens for competition.

Our entry into the telecom market as a carrier's carrier has enabled us to expand our opportunities beyond the electricity industry in Ontario. With our vast rights of way, significant potential exists for our Company to benefit from the tremendous growth in demand for data transmission.

Our financial position remains strong and we are pursuing a strategy to improve operational efficiency. It is through this strategy that we plan to generate the resources necessary to enhance the asset base, achieve our environmental objectives, pursue selected growth opportunities and to position our Company well, in the changing marketplace.

RECONCILIATION TO U.S. GAAP

The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). Net income under Canadian GAAP for 2000 was $68 million more than it would be under U.S. GAAP. Retained earnings under Canadian GAAP were $41 million more at December 31, 2000, than they would be under U.S. GAAP. See Note 23 to the Consolidated Financial Statements for a description of the principal differences between Canadian GAAP and U.S. GAAP, as they pertain to us. In addition, note that the Five-Year Summary of Financial and Operating Statistics on pages 70 and 71 includes information presented in accordance with U.S. GAAP.

Management's Report

The accompanying Consolidated Financial Statements of Hydro One Inc. (Hydro One or the Company) are the responsibility of management and have been prepared in accordance with accounting principles generally accepted in Canada. Hydro One applies accounting principles appropriate to its circumstances. The significant accounting policies followed by the Company are described in the summary of significant accounting policies contained in Note 2 to the Consolidated Financial Statements. The preparation of financial statements necessarily involves the use of estimates based on management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The Consolidated Financial Statements have been properly prepared within reasonable limits of materiality and in light of information available up to March 13, 2001.

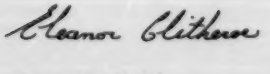
Management maintains a system of internal controls designed to provide reasonable assurance that the assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for appropriate delegation of authority and segregation of responsibilities. An internal audit function independently evaluates the effectiveness of these internal controls on an ongoing basis and reports its findings to management and the Audit and Finance Committee of the Hydro One Board of Directors.

The Consolidated Financial Statements have been examined by Ernst & Young LLP, independent external auditors appointed by the Hydro One Board of Directors. The external auditors' responsibility is to express their opinion on whether the Consolidated Financial Statements are fairly presented in accordance with generally accepted accounting principles. The Auditors' Report, which appears on page 43, outlines the scope of their examination and their opinion.

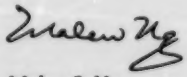
On March 31, 1999, Ontario Hydro ceased operations. Ontario Hydro's management was responsible for the financial statements of Ontario Hydro for the three months ended March 31, 1999, and year ended December 31, 1998, as set forth in Ontario Hydro's Final Annual Report for the period from January 1, 1998, to March 31, 1999. These Consolidated Financial Statements included the results of the businesses acquired by Hydro One Inc. on April 1, 1999.

As at April 1, 1999, Hydro One became operational under the name Ontario Hydro Services Company Inc. The Company name changed to Hydro One Inc. in May 2000. The Hydro One Board of Directors, through its Audit and Finance Committee, is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The Audit and Finance Committee of Hydro One met periodically with management, the internal auditors and the external auditors to satisfy itself that each group had properly discharged its respective responsibility and to review the Consolidated Financial Statements before recommending approval by the Board of Directors. The external auditors had direct and full access to the Audit and Finance Committee, with and without the presence of management, to discuss their audit and their findings as to the integrity of the financial reporting and the effectiveness of the system of internal controls.

On behalf of Hydro One Inc.'s Management:



Eleanor R. Clitheroe
President and Chief Executive Officer



Malen S. Ng
Executive Vice President and Chief Financial Officer

To the Shareholder of Hydro One Inc.:

We have audited the Consolidated Balance Sheets of Hydro One Inc. (the Company) as at December 31, 2000 and December 31, 1999, and the Consolidated Statements of Operations, Shareholder's Equity and Cash Flows of the Company for each of the years in the three-year period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian and United States generally accepted auditing standards for 2000 and Canadian generally accepted auditing standards for 1999 and 1998. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these Consolidated Financial Statements present fairly, in all material respects, the financial position of the Company as at December 31, 2000 and December 31, 1999, the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2000, in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP
Chartered Accountants
Toronto, Canada

February 26, 2001

Consolidated Statements of Operations

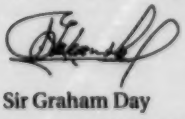
Year ended December 31 (Canadian dollars in millions)	**2000**	1999	1998
Revenues			
Transmission *(Note 17)*	**1,260**	1,237	1,178
Distribution (including retail) *(Note 17)*	**1,703**	1,793	1,729
Other	**32**	95	141
	2,995	3,125	3,048
Costs			
Operation, maintenance and administration *(Note 5)*	**856**	863	723
Purchased power *(Note 17)*	**866**	939	1,165
Depreciation and amortization *(Note 6)*	**348**	342	300
Transitional cost adjustment *(Note 7)*	**–**	55	–
Provincial debt guarantee fee *(Note 17)*	**–**	8	31
Deferred pension asset *(Note 13)*	**–**	–	(204)
	2,070	2,207	2,015
Other income			
Gain on sale of investment *(Note 8)*	**–**	32	–
Income before financing charges and provision for payments in lieu of corporate income taxes	**925**	950	1,033
Financing charges *(Notes 9 and 17)*	**340**	381	559
Income before provision for payments in lieu of corporate income taxes	**585**	569	474
Provision for payments in lieu of corporate income taxes *(Notes 10 and 17)*	**207**	194	–
Net income	**378**	375	474

See accompanying notes to Consolidated Financial Statements.

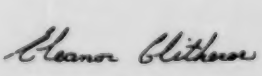
December 31 (Canadian dollars in millions)	**2000**	1999
Assets		
Current assets		
Cash and cash equivalents	–	468
Accounts receivable (net of allowance for doubtful accounts – $10 million; 1999 – $9 million)	511	536
Materials and supplies	65	81
	576	1,085
Fixed assets *(Note 11)*		
Fixed assets in service	12,375	11,907
Less: accumulated depreciation	4,108	3,848
	8,267	8,059
Construction in progress	252	300
	8,519	8,359
Other long-term assets		
Regulatory assets *(Note 12)*	352	383
Deferred pension asset *(Note 13)*	452	241
Long-term accounts receivable and other assets	78	20
Goodwill (net of amortization – $nil million) *(Note 4)*	6	–
Deferred debt costs	14	2
	902	646
Total assets	9,997	10,090
Liabilities		
Current liabilities		
Bank indebtedness	24	–
Accounts payable and accrued charges	357	403
Accrued interest	64	72
Short-term notes payable *(Note 14)*	130	–
Long-term debt payable within one year *(Note 14)*	474	1,399
	1,049	1,874
Long-term debt *(Note 14)*	3,972	3,446
Other long-term liabilities		
Employee future benefits other than pension *(Note 13)*	509	496
Regulatory liability *(Note 12)*	452	241
Long-term accounts payable and accrued charges	15	9
	976	746
Total liabilities	5,997	6,066
Contingencies and commitments *(Notes 3, 19 and 20)*		
Shareholder's equity *(Notes 3 and 16)*		
Preferred shares (authorized: unlimited; issued: 12,920,000)	323	–
Common shares (authorized: unlimited; issued: 100,000)	3,436	–
Shares to be issued	–	3,759
Retained earnings	241	265
Total shareholder's equity	4,000	4,024
Total liabilities and shareholder's equity	9,997	10,090

See accompanying notes to Consolidated Financial Statements.

On behalf of the Board:



Sir Graham Day
Chairman of the Board of Directors



Eleanor R. Clitheroe
President and Chief Executive Officer

Year ended December 31 (Canadian dollars in millions)	2000	1999	1998
Net assets of Acquired Businesses *(Note 3)*			
Balance, January 1	–	2,431	2,065
Net income (to March 31, 1999)	–	110	474
Net refund on annexations by municipalities	–	(25)	–
Pre-acquisition adjustments	–	1,243	–
Purchase of Acquired Businesses	–	(3,759)	–
Accounting change – employee future benefits other than pension *(Note 13)*	–	–	(108)
Balance, December 31	–	–	2,431
Shares to be issued (represented by promissory note) *(Note 3)*			
Balance, January 1	3,759	–	–
Issuance of note on purchase of Acquired Businesses	–	3,759	–
Cancellation of note on issuance of common and preferred shares	(3,759)	–	–
Balance, December 31	–	3,759	–
Common and preferred shares *(Note 16)*			
Balance, January 1	–	–	–
Issuance of 10 common shares in 1998 for nominal consideration	–	–	–
Issuance of 12,920,000 preferred shares in exchange for promissory note	323	–	–
Issuance of 99,990 common shares in exchange for promissory note	3,436	–	–
Balance, December 31	3,759	–	–
Retained earnings			
Balance, January 1	265	–	–
Net income (from April 1, 1999)	378	265	–
Dividends *(Note 16)*	(402)	–	–
Balance, December 31	241	265	–

See accompanying notes to Consolidated Financial Statements.

Year ended December 31 (Canadian dollars in millions)	2000	1999	1998
Operating activities			
Net income	378	375	474
Adjustments for non-cash items:			
Depreciation and amortization (net of removal costs)	324	424	276
Transitional cost adjustment	–	55	–
Gain on sale of investment	–	(32)	–
Deferred pension asset	–	–	(204)
	702	822	546
Changes in non-cash balances related to operations *(Note 18)*	11	129	(26)
Net cash generated from operations	713	851	520
Financing activities			
Debt for long-term financing:			
Issued	1,000	194	1,130
Retired	(1,399)	(962)	(1,228)
Debt for short-term financing	130	–	–
Deferred debt costs	(12)	(2)	–
Dividends paid	(398)	–	–
Net cash used in financing activities	(679)	(770)	(98)
Investing activities			
Fixed assets	(434)	(540)	(383)
Acquisition of municipal electricity utilities	(23)	–	–
Proceeds on disposal of fixed assets and investments	–	245	–
Other assets	(69)	43	–
Net cash used in investing activities	(526)	(252)	(383)
Net change in cash and cash equivalents	(492)	429	39
Cash and cash equivalents, January 1	468	39	–
Cash and cash equivalents, December 31 *(Note 18)*	(24)	468	39

See accompanying notes to Consolidated Financial Statements.

1. INCORPORATION AND COMMENCEMENT OF OPERATIONS

Hydro One Inc. (Hydro One or the Company) was incorporated on December 1, 1998, under the *Business Corporations Act* (Ontario) and issued 10 common shares for nominal consideration, and is wholly-owned by the Province of Ontario (the Province). As part of the reorganization of Ontario Hydro under the *Electricity Act, 1998*, and the related restructuring of the electricity industry in Ontario, Hydro One acquired and assumed certain assets, liabilities, rights and obligations of the electricity transmission, distribution and energy services businesses of Ontario Hydro (the Acquired Businesses) on April 1, 1999, and commenced operations on that date. In exchange, the Company issued debt and a promissory note, which was assumed by the Province in connection with the capitalization of the Company on March 31, 2000 (see Notes 3 and 16).

The principal business of Hydro One is the transmission and distribution of electricity to customers within Ontario and the business is primarily regulated by the Ontario Energy Board (OEB).

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

The Consolidated Financial Statements include the accounts of the Company and its wholly-owned subsidiaries: Hydro One Networks Inc., Ontario Hydro Energy Inc., Hydro One Remote Communities Inc., Hydro One Markets Inc., Hydro One Telecom Inc., Hydro One Network Services Inc., Ontario Hydro Delivery Services Company Inc. and Ontario Hydro International Inc.

Basis of accounting

These Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in Canada (Canadian GAAP) and conform with accounting principles generally accepted in the United States (U.S. GAAP), except as disclosed in Note 23.

The results of operations and cash flows presented in these Consolidated Financial Statements for periods prior to April 1, 1999, have been recorded in Hydro One's Consolidated Financial Statements on the same basis and in the same periods as originally recorded by Ontario Hydro. These financial statements, prior to April 1, 1999, have been prepared primarily through specific identification of assets, liabilities, revenues and expenses relating to such businesses, but also through an allocation of certain common financial statement accounts and items of Ontario Hydro.

Rate-setting

The *Ontario Energy Board Act, 1998* gave the OEB increased powers and responsibilities to regulate the electricity industry. These powers and responsibilities include the power to approve or fix rates for the transmission and distribution of electricity, the power to provide continued rate protection for rural and remote electricity consumers, and the responsibility for ensuring that distribution companies fulfill obligations to connect and service customers. Prior to April 1, 1999, Ontario Hydro was governed by the *Power Corporation Act*, which provided it with broad powers to generate, supply and deliver electricity throughout Ontario.

The transitional rate orders issued by the OEB effective April 1, 1999, approved the transmission and distribution revenue requirements for 1999 and 2000, which were designed to permit these regulated businesses to recover their allowed costs and to earn a forecasted annual rate of return of 9.35% for 1999 on average common equity deemed, for regulatory purposes, to be allocated to such businesses. For 2000, the OEB adjusted the rate of return to 9.88% to reflect higher forecasted interest rates for that year. Although Hydro One did not commence operations as a stand-alone enterprise separate from Ontario Hydro until April 1, 1999, the transitional rate orders formed the basis of revenue recognition for the three months ended March 31, 1999, consistent with a draft revenue allocation agreement among the successor corporations of Ontario Hydro.

In its capacity to approve or fix rates, the OEB has specified the following regulatory treatments that have resulted in accounting treatments differing from Canadian GAAP for enterprises operating in a non-rate-regulated environment:

I. Employee future benefits other than pension are recorded using the accrual method as required by Canadian GAAP. The OEB has allowed for the recovery of past service costs, which arose on the adoption of the accrual method, in the revenue requirement on a straight-line basis over a 10-year period. As a result, Hydro One recorded a regulatory asset in the original amount of $419 million to reflect this regulatory treatment;

II. Expenses incurred to align systems and practices with the requirements of the future competitive electricity market in Ontario (Market Ready costs) have been deferred in accordance with the initial criteria set out in the OEB's *Electricity Distribution Rate Handbook* and the *Accounting Procedures Handbook for Electric Distribution Utilities*. In the absence of such regulation, these costs would have been expensed when incurred under Canadian GAAP. Hydro One intends to apply for the recovery of these costs once the guidelines and timetable for this process have been established by the OEB;

III. In accordance with the Company's interpretation of the transitional rate orders approved by the OEB, pension costs are recorded in the results of operations when employer contributions are paid to the pension fund rather than on the accrual basis. As a result, a regulatory liability has been recorded in an amount equal to the deferred pension asset; and

IV. The Company provides for payments in lieu of corporate income taxes relating to its regulated businesses using the taxes payable method as directed by the OEB.

Revenue recognition and allocation

Wholesale customers in Ontario have traditionally been billed on a bundled basis, under which the billed amount aggregated the generation and transmission charges for the provision of electricity. Retail rates are also essentially bundled and set similarly to wholesale rates. Until the creation of competitive wholesale and retail electricity markets (Open Access), electricity customers will continue to pay bundled rates for electricity. Revenues are being collected, pooled and allocated to the successor corporations of Ontario Hydro consistent with a draft revenue allocation agreement among such corporations. This draft agreement incorporates the revenue requirements approved in the transitional rate orders issued by the OEB. Prior to 1999, transmission revenue was allocated based on an internal mechanism used by Ontario Hydro. The annual transmission revenue requirement was determined primarily based on an estimate of the planned cost components and a specified rate of return on assets.

Distribution (including retail) revenue represents actual, rather than allocated, revenues attributable to the sale and delivery of electricity, and is recognized as power is delivered to customers. Because customer meters are generally read on a quarterly basis, it is necessary to estimate the monthly revenue for the period based on wholesale power purchases. These estimates are reconciled to actual customer consumption on a regular basis.

Distribution revenue also includes an amount relating to rate protection for rural residential customers. The rural rate protection program that had been in effect since 1982 was repealed on April 1, 1999 and replaced with a comparable regime for rural rate protection under the *Ontario Energy Board Act, 1998*. Under this Act, in approving electricity rates for a distributor that delivers electricity to rural residential consumers, the OEB is required to provide rate protection for prescribed classes of consumers by reducing the electricity rates that would otherwise apply so that the weighted-average rural bill does not exceed the weighted-average municipal bill by more than 15%.

Corporate income and capital taxes

Prior to April 1, 1999, the Company's businesses were effectively carried out as business units of Ontario Hydro, which were exempt from corporate income and capital taxes.

Under the *Electricity Act, 1998*, Hydro One is required to make payments in lieu of corporate taxes to Ontario Electricity Financial Corporation (OEFC), commencing April 1, 1999. These payments are calculated in accordance with the rules for computing income and taxable capital and other relevant amounts contained in the *Income Tax Act* (Canada) and the *Corporations Tax Act* (Ontario) as modified by the *Electricity Act, 1998*, and related regulations.

The Company provides for payments in lieu of corporate income taxes relating to its regulated businesses using the taxes payable method as directed by the OEB. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from the customers of Hydro One at that time.

Materials and supplies

Materials and supplies represent spare parts and construction material held for internal construction and maintenance of fixed assets. These assets are carried at the lower of average cost and replacement cost.

Fixed assets

Fixed assets are capitalized at cost, which comprises materials, labour, engineering costs, overheads, depreciation on service equipment and the approved allowance for funds used during construction applicable to capital construction activities within regulated businesses or interest applicable to capital construction activities within unregulated businesses.

Fixed assets in service consist of transmission, distribution, communication, and administration and service assets. Fixed assets also include future use assets such as land and capitalized development costs associated with deferred capital projects.

Transmission

Transmission assets include assets used for the transmission of high-voltage electricity, such as transmission lines, support structures, foundations, insulators, connecting hardware and grounding systems, and assets used to step up the voltage of electricity from generating stations for transmission and to step down voltages for distribution, such as transformers, circuit breakers and switches.

Distribution

Distribution assets comprise assets related to the distribution of low-voltage electricity, including lines, poles, switches, transformers, protective devices and metering systems.

Communication

Communication assets include the microwave radio system, optical ground wire, towers, telephone equipment and associated buildings.

Administration and service

Administration and service assets include administrative buildings, major computer systems, personal computers, transport and work equipment, tools, vehicles and minor fixed assets.

Construction in progress

Financing costs are capitalized on fixed assets under construction within regulated businesses based on the regulator's approved allowance for funds used during construction (2000 – 8.0%; 1999 – 7.9%; 1998 – 9.4%). For non-regulated assets under construction, interest is capitalized at rates that approximate the average cost of all long-term funds borrowed (2000 – 8.0%; 1999 – 7.9%; 1998 – 9.4%).

Impairment of fixed assets

In the event that facts and circumstances indicate that a fixed asset may be impaired, an evaluation of recoverability is performed. For purposes of such an evaluation, the estimated future undiscounted cash flows associated with the fixed asset are compared to the asset's carrying amount to determine if a write-down is required.

Depreciation

The capital costs of fixed assets are depreciated on a straight-line basis, except for transport and work equipment and personal computers, which are depreciated on a declining balance basis.

Depreciation rates for the various classes of assets are based on their estimated service lives. The average estimated service lives and service life ranges of fixed assets are:

	Estimated service lives (years)	
	Range	Average
Transmission	12 – 100	51
Distribution	15 – 55	41
Communication	7 – 40	22
Administration and service	5 – 50	38

In accordance with group depreciation practices, the original cost of normal fixed asset retirements are charged to accumulated depreciation, with no gain or loss reflected in results of operations. Gains and losses on sales of fixed assets and losses on premature retirements are charged to results of operations as adjustments to depreciation expense. Depreciation expense also includes the costs incurred to remove fixed assets.

The estimated service lives of fixed assets are subject to periodic review. Any changes arising from such a review are implemented on a remaining service life basis from the year the changes can first be reflected in rates.

Employee Future Benefits

Employee future benefits provided by Hydro One include pension, group life insurance, health care, workers' compensation and long-term disability.

In accordance with the Company's interpretation of the transitional rate orders approved by the OEB, pension costs are recorded when employer contributions are paid to the pension fund. As a result, a regulatory liability is recorded in an amount equal to the deferred pension asset. The deferred pension asset arises as a result of the cumulative difference between employer contributions and pension costs. Pension plan assets are valued using fair values.

Employee future benefits are recorded on an accrual basis. Costs are determined by independent actuaries using the projected benefit method prorated on service and based on assumptions that reflect management's best estimates. Past service costs from plan amendments and actuarial gains or losses are amortized on a straight-line basis over the expected average remaining service life of the employees covered.

Employee future benefit costs are attributed to labour and charged to operations or capitalized as part of the cost of fixed assets accordingly.

Goodwill

Goodwill represents the cost of acquired municipal electricity utilities in excess of fair value of the net identifiable assets purchased and is amortized on a straight-line basis over 20 years. The recovery of goodwill, which is reported net of accumulated amortization, is evaluated on the basis of estimated future undiscounted cash flows as well as other factors.

Deferred debt costs

Deferred debt costs include the unamortized amounts of debt discounts or premiums arising from the issuance of debt and other costs. Deferred debt costs are amortized over the period to maturity of the debt on an annuity basis.

Foreign currency translation

Current monetary assets and liabilities in foreign currencies are translated to Canadian currency at year-end rates of exchange and the resulting exchange gains or losses are credited or charged to results of operations.

Use of estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses for the year. Actual results could differ from the estimates.

3. REORGANIZATION OF ONTARIO HYDRO

On March 31, 2000, the Company issued to the Province 12,920,000 5.5% cumulative preferred shares and 99,990 common shares. As consideration, the Province assumed Hydro One's obligations including accrued interest from April 1, 1999 under a promissory note and, in connection with the assumption of the Company's obligations by the Province, OEFC released Hydro One, effective as of March 31, 2000, from its obligations under the promissory note.

The capitalized value of the Company as at April 1, 1999 was determined as follows:

(Canadian dollars in millions)	
Excess of assets over liabilities of the Acquired Businesses, March 31, 1999	2,516
Adjustments:	
Elimination of allocated long-term debt from Ontario Hydro	5,382
Elimination of allocated short-term notes from Ontario Hydro	533
Elimination of allocated accrued interest	143
Elimination of allocated deferred debt costs	(228)
Debt issued effective April 1, 1999	(4,845)
	985
Regulatory asset – employee future benefits other than pension *(Note 12)*	419
Adjustment to deferred pension asset	164
Regulatory liability – deferred pension	(386)
Other net adjustments	61
	3,759
Represented by:	
Shares to be issued (represented by promissory note)	3,759

The purchase of the Acquired Businesses from the related party, OEFC, was recorded at the exchange amount of $8.6 billion, which approximated the book values of the assets acquired and liabilities assumed on April 1, 1999, and, in the current regulatory environment, approximated their fair value.

The actual net amount of assets and liabilities acquired on April 1, 1999 was less than estimates by $122 million. This excess of equity and liabilities over assets has been recorded as an account receivable, pending the outcome of the rate-setting process relating to pension costs and contributions in aid of construction.

The Consolidated Financial Statements include a deferred pension asset and an offsetting regulatory liability. The Company's interpretation of the transitional rate orders issued by the OEB for Hydro One effective April 1, 1999, is that the revenue requirement is based on pension costs being recorded in operations when employer contributions are paid to the pension fund. As a rate-regulated entity, Hydro One must account for pension costs on this basis for the regulated portions of the business. The OEB has indicated that the rate treatment of pension costs could be re-examined at a future rate hearing. In the event that the OEB determines that the pension costs should be included in the revenue requirement on an accrual basis, Hydro One would not be required to record a regulatory liability.

In addition, contributions in aid of construction are recorded as a nil amount, on a net basis, within fixed assets (see Note 11). On January 18, 2000, the OEB decided that contributions in aid of construction collected by municipal electricity utilities prior to January 1, 2000, in accordance with the previous regulatory environment, can continue to be recovered through the revenue requirement. If the OEB confirms that Hydro One can adopt the same regulatory accounting treatment related to its distribution assets, and this overall industry treatment is acceptable to the Province, then Hydro One would be required to record amounts for contributions in aid of construction, as approved by the regulator.

On January 19, 2001, Hydro One submitted an amended rate application to establish distribution rates for the period commencing with Open Access. The revenue requirement in the current application is based on employer contributions forming the basis for allowable pension costs. Contributions in aid of construction have been reflected in the cost of service submitted in the Company's application.

It has been proposed that the $122 million account receivable be adjusted through shareholder's equity. If it is determined that the regulatory liability should not be recorded or that amounts for contributions in aid of construction should be recorded, a post-acquisition adjustment would be made. Hydro One anticipates that the result of the post-acquisition adjustment would be to increase debt and shareholder's equity in a manner consistent with the original capital structure. At this time, the outcome of the rate-setting process, and the impact on debt, equity and other net assets, cannot be determined.

4. ACQUISITIONS OF MUNICIPAL ELECTRICITY UTILITIES

Hydro One has entered into numerous agreements to acquire the outstanding shares or assets of municipal electricity utilities. The Company accounts for such acquisitions using the purchase method with the acquired companies' results of operations being included in the Consolidated Statement of Operations from the date of acquisition. The purchase of each municipal electricity utility must be approved by the OEB prior to closing.

During 2000, Hydro One acquired 16 small municipal electricity utilities for cash consideration of approximately $23 million. Net identifiable assets acquired amounted to approximately $17 million, representing assets of $20 million and liabilities of $3 million. Based on the allocation of the purchase price, the transactions resulted in goodwill of $6 million.

In addition, Hydro One has entered into agreements for the purchase of 71 other municipal electricity utilities, which are expected to close in 2001. The aggregate cost of these acquisitions will be approximately $500 million. These acquisitions include the purchase of Brampton Hydro Corporation for cash consideration of approximately $260 million. Deposits in the amount of $57 million have been made in respect of these acquisitions.

5. OPERATION, MAINTENANCE AND ADMINISTRATION

In November 1999, Hydro One approved a staff reduction program intended to reduce cost levels. Although most of the costs associated with the staff reduction program were funded from the pension plan surplus, the Company recorded a provision in 1999 in the amount of $60 million primarily related to cash incentives and supplementary pension benefits that could not be charged to the pension surplus. The provision also included the estimated cost of limited targeted buy-outs and involuntary severance. The staff reduction program was substantially completed during 2000 and costs in the amount of $53 million were charged to the provision. In addition, the Company determined that $5 million of the provision related to supplementary pension benefits and involuntary severance would not be used and reversed this amount as a credit to the results of operations.

In 1999, Hydro One re-evaluated the need for some provisions previously recognized by Ontario Hydro and assumed by the Company on April 1, 1999. A remaining provision of $14 million associated with an involuntary staff reduction program originally recognized by Ontario Hydro in 1997 was reversed as a credit to the results of operations in 1999. In addition, due to a change in market and other business conditions, a real estate provision originally recorded by Ontario Hydro in 1993 in the amount of $22 million was reversed as a credit to the results of operations in 1999.

6. DEPRECIATION AND AMORTIZATION

Year ended December 31 (Canadian dollars in millions)	**2000**	1999	1998
Depreciation of fixed assets in service	**282**	272	276
Fixed asset removal costs	**24**	18	24
Amortization of regulatory assets	**42**	52	–
	348	342	300

7. TRANSITIONAL COST ADJUSTMENT

The transitional cost adjustment represents the difference between allowed costs specified in the OEB transitional rate orders, and costs incurred by Ontario Hydro during the first three months in 1999 that were allowed under the *Power Corporation Act*. Costs included in Hydro One's revenue requirement were higher due to payments in lieu of corporate taxes and an amount for amortization relating to the recovery of employee future benefits other than pension costs. These additional costs were partially offset by reduced financing charges resulting from lower debt balances that reflect the new capital structure of the Company and lower interest rates as well as the elimination of the provincial debt guarantee fee levied by the Province. The transitional cost adjustment was a non-recurring charge.

The following summarizes the components of the transitional cost adjustment for the three months ended March 31, 1999:

(Canadian dollars in millions)	1999
Depreciation and amortization	10
Payments in lieu of capital tax	6
Payments in lieu of corporate income taxes	87
Provincial debt guarantee fee	(8)
Financing charges	(40)
	55

8. ONTARIO HYDRO INTERNATIONAL INC.

On September 15, 1999, Hydro One's subsidiary, Ontario Hydro International Inc., sold its 25% equity interest in Ontario Quinta A.V.V. (Ontario Quinta), resulting in a gain before income taxes of $32 million. At the time of the sale, Ontario Quinta held a 60% interest in Luz del Sur S.A.A., an electricity distribution company serving southern Lima, Peru, and a 64% interest in Tecsur S.A.A., a utility maintenance and construction company also operating in Peru.

Prior to the sale, the results of operations, and the assets and liabilities of Ontario Quinta had been proportionately consolidated within Hydro One's financial statements.

The following summarizes the effects on the results of operations and financial position of using proportionate consolidation to account for the Ontario Quinta investment for the period prior to the sale. The effect on net income was equal to that which would have been obtained under the equity method (see Note 23).

Year ended December 31 (Canadian dollars in millions)	2000	1999	1998
Revenues	–	69	116
Operation, maintenance and administration	–	24	39
Purchased power	–	37	65
Depreciation and amortization	–	4	6
Financing charges	–	–	(3)
Net income	–	4	9

9. FINANCING CHARGES

Year ended December 31 (Canadian dollars in millions)	2000	1999	1998
Interest on short-term notes payable	2	–	30
Interest on long-term debt payable	377	411	539
Foreign exchange losses	–	–	6
Less: Interest charged to construction in progress	(22)	(18)	(10)
Interest earned on investments	(17)	(12)	(6)
	340	381	559

For the purpose of preparing historical financial statements, the financing charges of Ontario Hydro were notionally allocated to Hydro One and the other successor corporations for periods prior to April 1, 1999.

10. CORPORATE INCOME TAXES

The provision for payments in lieu of corporate income taxes (PILs) differs from the amount that would have been recorded using the combined Canadian Federal and Ontario statutory income tax rate. A reconciliation between the statutory and effective tax rates is provided as follows:

Year ended December 31 (Canadian dollars in millions)	2000	1999
Income before provision for PILs	585	569
PILs included in the transitional cost adjustment *(Note 7)*	–	87
Less: Income before provision for PILs for the period January 1 to March 31, 1999	–	(197)
Adjusted income before provision for PILs	585	459
Federal and Ontario statutory income tax rate	43.95%	44.62%
Provision for PILs at statutory rate	257	205
Increase (decrease) resulting from:		
The application of the income taxes payable method to the regulated businesses:		
Net temporary differences:		
Capital cost allowance in excess of depreciation and amortization	(44)	(50)
Charge for staff reduction program (lower than) in excess of cash payments	(23)	27
Interest capitalized for accounting purposes but deducted for tax purposes	(10)	(7)
Employee future benefits other than pension expense (lower than) in excess of cash payments	(4)	3
Other	8	–
Net temporary differences	(73)	(27)
Permanent differences:		
Large corporations tax	15	11
Other	8	5
Net permanent differences	23	16
Provision for PILs	207	194
Effective income tax rate	35.38%	42.27%

Future income taxes relating to the regulated businesses have not been recorded in the accounts as they are expected to be recovered through future revenues. As at December 31, 2000, future income tax liabilities of $80 million (1999 – $27 million), based on substantively enacted income tax rates, have not been recorded. Hydro One was not subject to PILs prior to April 1, 1999.

11. FIXED ASSETS

December 31 (Canadian dollars in millions)	Fixed assets in service	Accumulated depreciation	Construction in progress	Total
2000				
Transmission	**7,968**	**2,493**	**144**	**5,619**
Distribution	**3,441**	**1,097**	**85**	**2,429**
Communication	**383**	**194**	**5**	**194**
Administration and service	**583**	**324**	**18**	**277**
	12,375	**4,108**	**252**	**8,519**
1999				
Transmission	7,652	2,234	248	5,666
Distribution	3,350	1,132	47	2,265
Communication	323	178	1	146
Administration and service	582	304	4	282
	11,907	3,848	300	8,359

Fixed assets include contributions in aid of construction of $49 million for transmission (1999 – $50 million) and $215 million for distribution (1999 – $194 million). Contributions in aid of construction represent fixed assets owned by the Company. Since Hydro One did not pay for these assets, they have been recorded in the fixed asset accounts as nil, on a net basis.

Financing costs are capitalized on fixed assets under construction, including allowance for funds used during construction on regulated assets and interest on unregulated assets, and were $22 million in 2000 (1999 – $18 million).

During 1999, $75 million of distribution assets were transferred to municipal electricity utilities. Pursuant to certain provisions of the *Power Corporation Act*, some municipalities in Ontario were permitted to expand the service territories of their respective municipal electricity utilities to include areas that were served by Ontario Hydro. These expansions involved the transfer of distribution assets, liabilities and customers from Ontario Hydro to the relevant municipal electricity utility at a prescribed price. The price payable for the transferred assets was prescribed by the *Power Corporation Act* as being equal to the original cost of the assets less the sum of the accumulated net retail equity of $25 million and the accumulated depreciation associated with those assets as recorded in Ontario Hydro's books. The ability of municipalities to exercise this statutory expansion right ceased as of April 1, 1999.

12. REGULATORY ASSETS AND LIABILITY

Regulatory assets and liabilities arise as a result of the rate-making process. As described in Note 2, Hydro One has recorded the following regulatory assets and liability:

December 31 (Canadian dollars in millions)	2000	1999
Regulatory assets:		
Employee future benefits other than pension	335	377
Market Ready	17	6
Total regulatory assets	352	383
Regulatory liability:		
Deferred pension	452	241
Total regulatory liability	452	241

Hydro One intends to apply for recovery of the Market Ready costs, which include $25 million of related capitalized systems costs, once the guidelines and timetable for this process have been established by the OEB.

13. EMPLOYEE FUTURE BENEFITS

Pension

Hydro One established a contributory, defined benefit pension plan covering all regular employees of Hydro One and its subsidiaries on January 1, 2000. Until that date, employees and pensioners continued to participate in the Ontario Electricity Financial Corporation Pension Plan (OEFC Pension Plan), formerly the Ontario Hydro Pension and Insurance Plan. The pension information presented in the Consolidated Financial Statements for the period commencing on April 1, 1999 includes Hydro One's proportionate share of the OEFC Pension Plan assets and liabilities.

Subject to approval by the Financial Services Commission of Ontario, the OEFC Pension Plan is expected to transfer assets and liabilities to the successor plans, including the pension plan of Hydro One, in 2001.

The provisions of the *Electricity Act, 1998*, allow Hydro One to reduce employer contributions to the pension plan to the extent permitted under the *Pension Benefits Act*, effective April 1, 1998. As a result, the deferred pension asset was increased by $204 million with a corresponding credit to 1998 operations.

Effective January 1, 2000, Hydro One adopted the Canadian Institute of Chartered Accountants' (CICA) recommendations related to employee future benefits. The rate used to discount future benefits changed from management's best estimate to a market-based interest rate. Hydro One has applied the recommendations retroactively but has not restated individual comparative periods. The cumulative effect of this adoption was a $211 million increase to the deferred pension asset and the regulatory liability.

Employee Future Benefits other than Pension

In 1998, the rate used to discount future benefits was changed from management's best estimate to a market-based interest rate. The cumulative effect of this change was a $108 million increase in liabilities with a corresponding reduction in shareholder's equity.

	Pension		Employee Future Benefits other than Pension	
Year ended December 31 (Canadian dollars in millions)	2000	1999	2000	1999
Change in accrued benefit obligation				
Accrued benefit obligation, January 1, as previously stated	3,690	2,221	434	350
Adjustment related to adoption of new standard[1]	(230)	–	–	–
Accrued benefit obligation, January 1, as adjusted	3,460	2,221	434	350
Past service costs from plan amendments	–	–	14	–
Current service cost	55	75	15	16
Interest cost	246	215	35	29
Benefits paid	(199)	(168)	(39)	(29)
Net actuarial loss (gain)	242	(26)	85	(108)
Staff reduction program	–	234	3	10
Allocation adjustment[2]	–	1,139	–	166
Accrued benefit obligation, December 31	3,804	3,690	547	434
Change in plan assets				
Fair value of plan assets, January 1	4,296	2,474	–	–
Actual return on plan assets	301	519	–	–
Employer contributions	–	–	–	–
Employees' contributions	16	17	–	–
Benefits paid	(199)	(168)	–	–
Administrative expenses	(7)	(7)	–	–
Allocation adjustment	–	1,461	–	–
Fair value of plan assets, December 31	4,407	4,296	–	–
Funded status				
Funded excess (unfunded benefit obligation)	603	606	(547)	(434)
Unamortized net actuarial losses (gains)	270	(365)	–	(98)
Unamortized past service costs	–	–	11	–
Deferred benefit asset (accrued benefit liability)	873	241	(536)	(532)
Valuation allowance[3]	(421)	–	–	–
Deferred pension asset, net of valuation allowance (accrued benefit liability)	452	241	(536)	(532)
Less: current portion	–	–	27	36
Deferred pension asset, net of valuation allowance (long-term liability)	452	241	(509)	(496)

[1] Includes past service costs from plan amendments of $63 million recognized on adoption of new standard.

[2] Effective April 1, 1999, employee future benefits have been based on the actual number of Hydro One employees and pensioners. Prior to April 1, 1999 employee future benefits were based on a proportionate share of Ontario Hydro's payroll.

[3] The valuation allowance reduces the deferred pension asset to the maximum future benefit Hydro One expects to realize from the plan surplus.

Year ended December 31 (Canadian dollars in millions)	Pension 2000	Pension 1999	Pension 1998	Employee Future Benefits other than Pension 2000	Employee Future Benefits other than Pension 1999	Employee Future Benefits other than Pension 1998
Components of net periodic benefit cost						
Current service cost, net of employee contributions	**39**	58	35	**15**	16	14
Interest cost	**246**	215	148	**35**	29	20
Expected return on plan assets	**(316)**	(275)	(246)	**–**	–	–
Amortization of net actuarial (gains) losses	**–**	(19)	(50)	**(2)**	7	2
Amortization of past service costs	**–**	–	24	**1**	–	2
Amortization of transitional asset	**–**	–	(8)	**–**	–	–
Staff reduction program	**–**	165	–	**(4)**	–	–
Adjustment for plan surplus ownership	**–**	–	102	**–**	–	–
Change in valuation allowance	**31**	–	–	**–**	–	–
Adjustment due to transitional rate orders *(Note 2)*	**–**	(141)	–	**–**	–	–
Net periodic benefit cost	**–**	3	5	**45**	52	38
Capitalized as part of the cost of fixed assets	**–**	1	1	**21**	22	7
Charged to operations	**–**	2	4	**24**	30	31
Effect of 1% increase in health care cost trends on:						
Accrued benefit obligation, December 31	**–**	–	–	**54**	35	37
Net periodic benefit cost	**–**	–	–	**5**	4	3
Effect of 1% decrease in health care cost trends on:						
Accrued benefit obligation, December 31	**–**	–	–	**(44)**	(29)	(29)
Net periodic benefit cost	**–**	–	–	**(4)**	(3)	(3)
Significant assumptions						
Weighted-average discount rate	**6.75%**	6.50%	6.00%	**6.88%**	7.38%	5.91%
Rate of compensation scale escalation	**3.25%**	3.50%	3.50%	**3.25%**	3.50%	3.50%
Rate of return on plan assets	**7.75%**	7.25%	9.00%	**–**	–	–
Rate of cost of living increase	**2.50%**	2.50%	2.50%	**2.50%**	2.50%	2.50%
Average remaining service life of employees (years)	**14**	11	12	**14**	11	12
Rate of increase in long-term medical costs[1]	**–**	–	–	**4.50%**	4.50%	4.50%
Rate of increase in dental costs	**–**	–	–	**3.50%**	3.50%	3.50%

[1] 9.00% grading down to 4.50% after five years (1999 – 7.20% grading down to 4.50% after three years).

14. DEBT

December 31 (Canadian dollars in millions)	2000	1999
Short-term notes payable	130	–
Long-term debt		
Notes payable to OEFC	3,446	4,845
6.94% debentures due 2005	200	–
7.15% debentures due 2010	400	–
7.35% debentures due 2030	400	–
	4,446	4,845
Less: long-term debt payable within one year	474	1,399
Long-term debt	3,972	3,446

Short-term debt represents promissory notes issued pursuant to the Company's commercial paper program. The notes are denominated in Canadian dollars with varying maturities not exceeding 365 days and with a weighted-average interest rate of 5.75%.

The long-term debt is unsecured and denominated in Canadian dollars. Such debt is summarized by the number of years to maturity in the following table:

Years to Maturity	Principal Outstanding on Debentures *(Canadian dollars in millions)*	Principal Outstanding on Notes Payable to OEFC *(Canadian dollars in millions)*	Weighted-Average Interest Rate *(percent)*
1 year	–	474	7.20
2 years	–	443	10.96
3 years	–	651	7.22
4 years	–	682	6.78
5 years	200	307	7.72
	200	2,557	
6 – 10 years	400	889	9.07
Over 10 years	400	–	7.35
	1,000	3,446	8.13

Hydro One has committed and unused revolving credit agreements with a syndicate of banks in the amount of $500 million which matures in 2001 and $250 million which matures in 2005. If used, interest on the lines of credit would apply based on Canadian benchmark rates. These credit agreements support the Company's commercial paper program.

15. FAIR VALUE OF FINANCIAL INSTRUMENTS AND CREDIT RISK

Fair value

The following table presents the carrying amounts and fair values of financial instruments:

December 31 (Canadian dollars in millions)	2000		1999	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term debt	4,446	4,873	4,845	5,175

The fair value of long-term debt is based on year-end quoted market prices for same or similar debt of the same remaining maturities.

The carrying values of cash and cash equivalents, accounts receivable, bank indebtedness, short-term notes payable and accounts payable and accrued charges approximate fair value because of the short maturity of these instruments.

Credit Risk

Financial assets create a risk that a counter-party will fail to discharge an obligation, causing a financial loss. As at December 31, 2000, there were no significant concentrations of credit risk with respect to any class of financial assets. The Company's revenue is earned from a broad base of customers consistent with the draft revenue allocation agreement among the successor corporations. As a result, Hydro One did not earn a significant amount of revenue from any single customer. In addition, the Company has not entered into any derivative financial instruments.

16. SHARE CAPITAL

On March 31, 2000, the Company issued to the Province 12,920,000 5.5% cumulative preferred shares with a redemption value of $25.00 per share, and 99,990 common shares, bringing the total number of outstanding common shares to 100,000. The Company is authorized to issue an unlimited number of preferred and common shares.

The preferred shares are entitled to an annual cumulative dividend of $18 million, which is payable on a quarterly basis. The preferred shares are redeemable at the option of the Province at a price of $25.00 per share plus any accrued and unpaid dividends if the Province sells a number of the Company's common shares which it owns to the public such that the Province's holdings are reduced to less than 50% of the Company's common shares. Hydro One may elect to pay all or part of this redemption price by issuing additional common shares to the Province. If the Province does not exercise its redemption right, the Company would have the ability to adjust the dividend on the preferred shares to produce a yield that is 0.50% less than the then-current dividend market yields for similarly rated preferred shares. The preferred shares do not carry voting rights, except in limited circumstances, and would rank in priority to the common shares upon liquidation.

The common dividends are declared at the sole discretion of the Hydro One Board of Directors, and recommended by management based on results of operations, financial condition, cash requirements and other relevant factors such as industry practice and shareholder expectations.

In accordance with resolutions made by the Board of Directors, in respect of the nine months ended December 31, 1999, $13 million in preferred dividends and $158 million in common dividends were paid to the Province on March 31, 2000. In respect of 2000, preferred dividends in the amount of $18 million and common dividends in the amount of $213 million were declared during the year, for a total of $231 million.

17. RELATED PARTY TRANSACTIONS

Prior to April 1, 1999, Hydro One, Ontario Power Generation Inc. (OPG), the Electrical Safety Authority (ESA) and the Independent Market Operator (IMO) were, in effect, business units of Ontario Hydro. Inter-business unit transactions are not available for 1998 due to the integrated nature of the operations of these entities. Upon the reorganization of Ontario Hydro, OPG, ESA and IMO became related parties of Hydro One because all of these entities are controlled by the Province.

Hydro One receives revenue for transmission services consistent with the draft revenue allocation agreement administered by OPG (see Note 2). Transmission revenue for 2000 includes $1,183 million (1999 – $1,164 million) related to these services.

Hydro One receives a portion of its distribution (including retail) revenue pursuant to the draft revenue allocation agreement administered by OPG that will terminate upon Open Access (see Note 2). Under this agreement, distribution (including retail) revenue for 2000 includes $59 million (1999 – $106 million).

Hydro One receives amounts for rural rate protection from customer revenue collected by the IMO (the Province prior to April 1, 1999) (see Note 2). Distribution (including retail) revenue includes $127 million (1999 – $127 million) related to this program, of which $7 million (1999 – $7 million) was paid to municipal electricity utilities in respect of annexation agreements.

Hydro One purchased power from OPG in the amount of $857 million in 2000 (1999 – $900 million).

Hydro One has several service level agreements with the other successor corporations, primarily OPG. These services are provided or received on a cost recovery basis and include field and engineering, logistics, corporate, telecommunication and information technology services. Revenues for 2000 include $64 million (transmission – $61 million; distribution (including retail) – $3 million) (1999 – $64 million: transmission – $58 million; distribution (including retail) – $6 million) related to the provision of services to the other successor corporations and operation, maintenance and administration costs for 2000 include $18 million (transmission – $15 million; distribution (including retail) – $3 million) (1999 – $47 million: transmission – $32 million; distribution (including retail) – $15 million) related to the purchase of services from the other successor corporations.

As at December 31, 2000, long-term debt in the amount of $3,446 million (1999 – $4,845 million) was due to OEFC. Financing charges include interest expense on this debt in the amount of $330 million (1999 – $411 million). Allocated debt for the period prior to April 1, 1999 included bonds and notes payable to the Province as well as to unrelated parties. In respect of the allocated debt, Hydro One paid a debt guarantee fee to the Province. Since commencement of operations, the Province has not guaranteed Hydro One's debt, and accordingly, the provincial debt guarantee fee is no longer incurred.

Provision for payments in lieu of corporate taxes were paid or payable to OEFC and dividends were paid or payable to the Province (see Note 2).

The amounts due to and from related parties as a result of the transactions referred to above are as follows:

December 31 (Canadian dollars in millions)	2000	1999
Accounts receivable	144	144
Accounts payable and accrued charges	(157)	(169)

18. CONSOLIDATED STATEMENTS OF CASH FLOWS

For the purposes of the consolidated statements of cash flows, balance sheet item "bank indebtedness" has been netted against "cash and cash equivalents."

The changes in non-cash balances related to operations consist of the following:

Year ended December 31 (Canadian dollars in millions)	2000	1999	1998
Accounts receivable decrease (increase)	25	(16)	17
Materials and supplies decrease (increase)	16	(16)	(15)
Accounts payable and accrued charges (decrease) increase	(46)	128	(52)
Accrued interest (decrease) increase	(8)	78	(8)
Long-term accounts payable and accrued charges increase (decrease)	6	(72)	(7)
Employee future benefits other than pension increase	13	36	5
Other	5	(9)	34
	11	129	(26)
Supplementary information:			
Interest paid	384	324	576
Payments in lieu of corporate income taxes	213	169	–

19. CONTINGENCIES

Legal proceedings

As a result of Hydro One's acquisition of certain transmission, distribution and energy services assets, liabilities, rights and obligations of Ontario Hydro, Hydro One has succeeded Ontario Hydro as a party in a number of legal proceedings. In 1995, Torcom Communications Inc. (Torcom) named Ontario Hydro as one of several defendants in a suit seeking damages of $150 million, as well as specific performance of certain agreements and interim injunctive relief. Torcom had sought to purchase certain telecommunication devices belonging to a bankrupt company from the court-appointed receiver in bankruptcy. The devices had been installed on Ontario Hydro property under licence to the original owner. Torcom claims that it reached an agreement with Ontario Hydro for the continued placement of the devices on Ontario Hydro property. Torcom alleges Ontario Hydro breached this contract and interfered with its efforts to purchase the devices from the receiver. There has been little activity on the case since 1995, when Ontario Hydro served a demand to particularize the allegations against it. Ontario Hydro did not receive a reply to its demand for particulars and has not yet served a statement of defense. Hydro One believes that there are strong defenses to the plaintiff's claims against Ontario Hydro and that it is unlikely that the outcome of the litigation will have a material adverse effect on its business, results of operations, financial position or prospects.

Hydro One is one of many defendants in a suit in the Superior Court of Justice commenced on October 18, 1995, asserting aboriginal title to certain land within the City of Sarnia. The plaintiff, The Chippewas of Sarnia Band, alleges that the land was not properly surrendered before a Crown Patent was issued in 1853 and therefore subsequent owners who took possession under the Crown Patent do not possess valid title. Hydro One maintains transmission line facilities on portions of the disputed land. Hydro One cannot estimate the costs that might result from an adverse decision. On April 30, 1999, summary judgement was granted, dismissing the action against Ontario Hydro and certain of the defendants. On May 27, 1999, the plaintiff appealed the summary judgement order to the Court of Appeal for Ontario. Further, several defendants have also appealed the summary judgement order and others, including Hydro One, have filed cross-appeals. The appeals were argued in June 2000. The Court of Appeal decision rendered December 21, 2000 dismissed the plaintiffs' appeal and granted the appeals of the other parties. The plaintiff has given notice they are seeking leave to appeal to the Supreme Court of Canada and have asked the Court for a time extension to file their appeal materials. Given the nature and issues of this case, it is likely that leave to appeal will be granted. Hydro One believes that it is unlikely that the outcome of this litigation will have a material adverse effect on its business, results of operations, financial position or prospects.

On March 29, 1999, the Whitesand First Nation Band commenced an action in the Ontario Court (General Division), naming as defendants the Province, the Attorney General of Canada, Ontario Hydro, OEFC, OPG and the Company. A notice of intent to defend was filed on behalf of Hydro One. The action seeks declaratory relief, injunctive relief and damages in an unspecified amount. The Whitesand Band alleges that since at least the first half of the twentieth century, Ontario Hydro has erected dams, generating stations and other facilities within or affecting the band's traditional lands and that such facilities have caused damage to band members and the lands, including substantial flooding and erosion. The Whitesand Band also claims treaty rights to a share of the profits arising from the activities of these Ontario Hydro facilities, an entitlement to increases in annuity payments established by treaty and compensation for costs incurred in the course of prior negotiations of band grievances with Ontario Hydro. The Whitesand Band asserts multiple causes of action, including trespass, breach of fiduciary duty, nuisance and negligence. Hydro One believes that it is unlikely that the outcome of this litigation will have a material adverse effect on its business, results of operations, financial position or prospects.

Transfer of Assets

On April 1, 1999, in connection with the acquisition of its operations, Hydro One acquired and assumed assets, liabilities, rights and obligations of Ontario Hydro's electricity transmission, distribution and energy services businesses, except for certain transmission, distribution and other assets located on lands held for bands or bodies of Indians under the *Indian Act* (Canada). Transfer of title to these assets did not occur because authorizations originally granted by the Minister of Indian Affairs and Northern Development (Canada) for the construction and operation of these assets could not be transferred without the consent of the Minister and the relevant Indian bands or bodies or, in several cases, because the authorizations had either expired or had never been properly issued. Hydro One manages these assets, which are currently owned by OEFC.

Hydro One has commenced negotiations with the relevant Indian bands and bodies to obtain the authorizations and consents necessary to complete the transfer of these transmission, distribution and other assets. Hydro One cannot predict the aggregate amount that it may have to pay to obtain the required authorizations and consents. Hydro One expects to pay more than $850,000 per year, which was the amount previously paid to these Indian bands and bodies by Ontario Hydro and which is the total amount of allowed costs in the transitional rate orders. If after taking all reasonable steps, Hydro One cannot otherwise obtain the authorizations and consents from the Indian bands and bodies, OEFC will continue to hold these assets for an indefinite period of time. Alternatively, Hydro One may have to relocate these assets from the Indian lands to other locations at a cost that could be substantial, or, in a limited number of cases, to abandon a line and replace it with diesel generation facilities. In such cases, Hydro One would apply to the OEB to recover these costs in future rate orders.

Environment

Hydro One is subject to extensive Canadian federal, provincial and local regulation with respect to environmental and other health and safety matters. Governmental authorities regulate current operating facilities and exercise continuing jurisdiction over facility modifications. Hydro One is subject to an Administrative Order issued against Ontario Hydro by the Ontario Ministry of the Environment on September 2, 1997. The order requires that power generating facilities where discharges are causing or may cause adverse effects, or where waste is stored without approval, be identified, assessed and, if necessary, remediated. This order affects remote generating station sites and generating station switchyards operated by Hydro One. Hydro One's current estimates indicate that the total cost for assessment and remediation at the remote generating station sites will be approximately $17 million over a four to six year period. Hydro One's current estimate of its remediation and assessment costs associated with the generating station switchyards is approximately $3 million over a four to six year period.

Environmental regulations can change rapidly and may be difficult to predict. Because new or existing facilities may be subject to new standards imposed by environmental regulation, substantial expenditures may be required to comply with such regulations. Hydro One is currently reviewing the environmental condition of various properties, and costs for investigation or remediation of such properties may exceed estimated amounts depending on the results of such review. Hydro One analyzes the costs of its obligations arising from environmental matters on an ongoing basis. The ultimate resolution of future environmental matters is not expected to have a material adverse effect upon the financial position or results of operations of Hydro One.

20. COMMITMENTS

The future minimum lease payments under operating leases for each of the five years subsequent to December 31, 2000 and in total thereafter are as follows:

Year ended December 31 (Canadian dollars in millions)	
2001	20
2002	18
2003	14
2004	12
2005	8
Thereafter	11
Total future minimum lease payments	83

21. SEGMENT REPORTING

Hydro One has three reportable segments:

I. The transmission business, which comprises the core business of providing transportation and connection services, as well as various services such as telecommunications and secondary land use, and is responsible for transmitting electricity throughout the Ontario electricity grid;
II. The distribution (including retail) business, which comprises the core business of delivering and selling electricity to customers; and
III. An "other" segment primarily consisting of energy services, power procurement, telecom, head office and the results of Ontario Hydro International Inc.

The designation of segments has been based on a combination of regulatory status and the nature of the products and services provided. The accounting policies followed by the segments are the same as those described in the summary of significant accounting policies (see Note 2).

Segment information on the above basis is as follows:

Year ended December 31 (Canadian dollars in millions)	2000	1999	1998
Transmission			
Revenues	1,260	1,237	1,178
Operation, maintenance and administration	433	423	349
Purchased power	–	–	17
Depreciation and amortization	198	179	179
Segment profit before transitional cost adjustment, provincial debt guarantee fee, deferred pension asset and financing charges	629	635	633
Distribution (including retail)			
Revenues	1,703	1,793	1,729
Operation, maintenance and administration	388	382	318
Purchased power	857	900	1,083
Depreciation and amortization	143	152	108
Segment profit before transitional cost adjustment, provincial debt guarantee fee, deferred pension asset and financing charges	315	359	220
Other			
Revenues	32	95	141
Operation, maintenance and administration	35	58	56
Purchased power	9	39	65
Depreciation and amortization	7	11	13
Segment (loss) profit before transitional cost adjustment, provincial debt guarantee fee, deferred pension asset and financing charges	(19)	(13)	7
Capital expenditures			
Transmission	280	327	171
Distribution (including retail)	175	186	188
Other	14	16	35
	469	529	394

December 31 (Canadian dollars in millions)	2000	1999
Total assets		
Transmission	6,492	6,658
Distribution (including retail)	3,434	3,377
Other	71	55
	9,997	10,090

All revenues, costs and assets, as the case may be, are earned, incurred or held in Canada, except for the operations of Ontario Hydro International Inc. in years prior to 2000 (see Note 8).

22. COMPARATIVE FIGURES

The comparative Consolidated Financial Statements have been reclassified from statements previously presented to conform to the presentation of the December 31, 2000 Consolidated Financial Statements.

23. RECONCILIATION TO U.S. GAAP

The Consolidated Financial Statements of Hydro One have been prepared in accordance with Canadian GAAP, which conforms in most respects to U.S. GAAP. Under both Canadian GAAP and U.S. GAAP, certain of the Company's accounting policies differ from those that would be followed by enterprises operating in a non-rate-regulated environment.

The material differences between Canadian GAAP, as used in the preparation of these Consolidated Financial Statements, and U.S. GAAP, are summarized below.

Consolidated Statements of Operations

Year ended December 31 (Canadian dollars in millions)	2000	1999	1998
Net income	378	375	474
Adjustments increase (decrease):			
Pension costs (a)	–	–	(25)
Other post-retirement benefit costs (a)	–	–	(7)
Other post-employment benefit costs (a)	(6)	8	12
Staff reduction charges (b)	(60)	45	(6)
Corporate write-offs (c)	(2)	(24)	(2)
Net income and comprehensive income (U.S. GAAP)	310	404	446
Retained earnings, opening	292	–	–
Dividends	(402)	–	–
Excess of assets over liabilities, March 31, 1999	–	(2,870)	–
Excess of assets over liabilities, opening (U.S. GAAP)	–	2,758	2,312
Excess of assets over liabilities, closing (U.S. GAAP)	–	–	2,758
Retained earnings, December 31 (U.S. GAAP)	200	292	–

Consolidated Balance Sheets

December 31 (Canadian dollars in millions)	2000	1999
Assets: increase (decrease)		
Fixed assets in service (a),(c)	24	16
Deferred pension asset (a)	–	150
Regulatory assets – environmental (d)	265	158
Regulatory assets – deferred tax (e)	97	27
Liabilities: (increase) decrease		
Accounts payable and accrued charges (b),(c)	8	46
Other post-retirement and post-employment benefits (a)	(11)	13
Long-term accounts payable and accrued charges (d)	(265)	(158)
Regulatory liability – deferred pension (a)	–	(150)
Deferred tax liability (e)	(97)	(27)
	21	75

(a) Employee future benefits

With the adoption of the CICA's accounting recommendations with respect to employee future benefits and the completion of the 1999 staff reduction program, the Company's accounting for employee future benefits (pension, other post-retirement and post-employment benefits (OPEB)) substantially conforms to U.S. GAAP as at December 31, 2000.

Pension

Under U.S. GAAP, additional liabilities of $229 million associated with the staff reduction program would have been recognized as a reduction in the deferred pension asset and corresponding regulatory liability in 2000 rather than in 1999 (see item (b) below).

At December 31, 1999, the amount of the deferred pension asset, and corresponding regulatory liability, would have been $391 million under U.S. GAAP. This compares with the $241 million deferred pension asset and regulatory liability recorded on the Company's balance sheet at December 31, 1999. The difference of $150 million reflects the timing difference of recognizing the additional liabilities associated with the voluntary retirement program.

The 1999 deferred pension asset, corresponding regulatory liability and 1998 pension costs also differed under U.S. GAAP because of the timing of the adoption of the CICA's accounting recommendations.

Employee future benefits other than pension

Under U.S. GAAP, the OPEB liabilities at December 31, 2000 and 2000 OPEB cost would have been $11 million higher due to the immediate recognition of the actuarial loss due to a change in the current market settlement rate at December 31, 2000. Of this, $6 million would have been charged to the results of operations and $5 million to the cost of fixed assets.

Under U.S. GAAP, the OPEB liabilities at December 31, 1999 and 1999 OPEB cost would have been $13 million lower due to the immediate recognition of the actuarial gain due to a change in the current market settlement rate at December 31, 1999. Of this, $8 million would have been credited to results of operations and $5 million to the cost of fixed assets.

Costs related to employee future benefits other than pension recorded in 1998 differed under U.S. GAAP because of the timing of the adoption of the CICA's accounting recommendations.

(b) Staff reduction charges

Under Canadian GAAP prior to January 1, 2000, costs relating to staff reduction programs are recognized at the time management approves such reductions and the costs can be reasonably estimated, including costs associated with a voluntary retirement program. Under U.S. GAAP, the cost of staff reduction programs may not be recognized unless the program specifically identifies the number of employees and their job classification and location, and the terminations will occur within one year from the date that management approves the reduction program. Under U.S. GAAP, the cost of offering a voluntary program can only be recognized when employees actually accept an offer of early retirement.

Ontario Hydro recorded a provision for staff reduction costs in the amount of $18 million in 1997. An additional $3 million was allocated to Hydro One on April 1, 1999. Actual staff reduction expenditures of $6 million and $1 million were incurred during 1998 and 1999, respectively. Hydro One reversed the remaining provision of $14 million as a credit to results of operations in 1999. Under U.S. GAAP, the original provision and its subsequent reversal would not have been recorded and the actual expenditures incurred would have been charged to the results of operations during 1998 and 1999.

During 1999, Hydro One recorded a new provision for staff reduction costs in the amount of $60 million and in 2000, Hydro One reversed $5 million of this provision as a credit to the results of operations. Under U.S. GAAP, the original provision would not have been recorded in 1999. Instead, a provision for $55 million would have been recorded in 2000 as employees actually accepted the early retirement offer. Therefore, U.S. GAAP income would have been lower in 2000 by $60 million due to a combination of the $55 million staff reduction provision and the absence of the $5 million credit resulting from the 2000 reversal of a portion of the provision recognized under Canadian GAAP in 1999.

(c) Corporate write-offs

In 1997, Ontario Hydro recorded a $33 million expense related to the future disposal of certain field operation centres. This amount included $25 million for the write-down of specific fixed assets and $8 million for a provision for non-discretionary post-occupancy costs. Under U.S. GAAP, the fixed assets would have remained on the balance sheet as assets held for future use and would have continued to be depreciated at $2 million per year. In addition, the provision for non-discretionary post-occupancy costs would not have been recorded.

In 1993, Ontario Hydro recorded a real estate provision in the amount of $22 million, which was reversed by Hydro One as a credit to results of operations in 1999. Under U.S. GAAP, the provision and its subsequent reversal would not have been recorded.

(d) Environmental costs

Hydro One expenses the costs to settle past environmental damage as those costs are incurred. That policy is also the basis on which the Company's transmission and distribution rates have been set. Under U.S. GAAP, a liability should be recognized for such costs when it is likely that a liability has been incurred and when the amount and timing of the future costs are reasonably estimable. Because the Company's rates have been set to recover environmental costs on an as-incurred basis, and it is expected the regulator will continue to permit that treatment, under U.S. GAAP a regulatory asset would be recognized in the same amount as the environmental cost liability. Thus, there would be no change in reported net income as a result of applying U.S. GAAP for environmental costs.

For U.S. GAAP purposes, a liability and regulatory asset of $265 million would be recognized at December 31, 2000 (1999 – $158 million). The increase in the liability from 1999 to 2000 was primarily due to revised cost estimates based on experience gained in inspecting and testing transformers for PCB contamination.

In the Consolidated Financial Statements for the year ended December 31, 1999, the Company's disclosure of differences between U.S. and Canadian GAAP for environmental costs did not take account of the regulatory asset that would be recognized under U.S. GAAP. The amounts now reported for purposes of U.S. GAAP have been restated from those previously reported. U.S. GAAP net income for 1999 is $35 million lower (1998 – $9 million higher) than previously reported. The excess of assets over liabilities at January 1, 1998 for purposes of U.S. GAAP is $184 million higher than previously reported.

(e) Deferred income taxes

U.S. GAAP requires the reporting and display of deferred income tax liabilities and assets on the balance sheet. To the extent that the deferred income taxes are expected to be included in the approved rates charged to customers in the future, the Company would record a regulatory asset. The amount of deferred taxes reported for U.S. GAAP, determined on the basis of enacted income tax rates, is based on information included in Note 10.

(f) Proportionate consolidation of joint ventures

Under Canadian GAAP, Hydro One accounted for its indirect investment in Ontario Quinta using the proportionate consolidation method (see Note 8). Under U.S. GAAP, Hydro One's indirect investment in Ontario Quinta would have been accounted for using the equity method. However, U.S. securities regulations allow Hydro One to omit from the U.S. GAAP reconciliation the differences resulting from the use of the proportionate consolidation method, subject to the provision of the information included in Note 8.

(g) Transitional cost adjustment

As set forth in Note 7 to the Consolidated Financial Statements, the Company recorded a transitional cost adjustment in the first three months of 1999. Under U.S. GAAP, the transitional cost adjustment would not be recognized as a specific cost line item in the first three months of 1999. Instead, under U.S. GAAP, the transitional cost adjustment would have been netted against revenue.

(h) Statement of cash flows

Under U.S. GAAP, bank indebtedness is not included in deriving cash and cash equivalents for purposes of the statement of cash flow. Bank indebtedness is classified as a financing activity.

(i) Future accounting pronouncements

The U.S. Financial Accounting Standards Board has issued new standards on accounting for derivative financial instruments and hedging activities under Statement No. 133, effective for fiscal years beginning on or after June 15, 2000. Statement No. 133 establishes accounting and reporting standards requiring that all derivative instruments (including certain derivative instruments embedded in other contracts) be recorded on the balance sheet as either assets or liabilities measured at their fair value. In addition, Statement No. 133 requires that changes in a derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. If these criteria are met, and the Company has formally documented, designated and assessed the effectiveness of qualifying transactions, gains and losses on the derivatives may be offset against losses and gains on the hedged item in the income statement. Hydro One has not yet entered into any derivative transactions and therefore, has determined that the new standard currently has no impact on its Consolidated Financial Statements.

Year ended December 31 (Canadian dollars in millions)	**2000**	1999	1998	1997	1996
Statement of operations data					
Revenues	**2,995**	3,125	3,048	3,099	3,129
Costs					
Operation, maintenance and administration[2]	**856**	863	723	706	602
Purchased power	**866**	939	1,165	1,250	1,218
Depreciation and amortization	**348**	342	300	302	305
Transitional cost adjustment[3]	**–**	55	–	–	–
Provincial debt guarantee fee[4]	**–**	8	31	32	31
Deferred pension asset	**–**	–	(204)	–	–
	2,070	2,207	2,015	2,290	2,156
Other income					
Gain on sale of investment[5]	**–**	32	–	–	–
Income before financing charges and provision for payments in lieu of corporate income taxes	**925**	950	1,033	809	973
Financing charges	**340**	381	559	584	590
Income before provision for payments in lieu of corporate income taxes	**585**	569	474	225	383
Provision for payments in lieu of corporate income taxes[6]	**207**	194	–	–	–
Net income	**378**	375	474	225	383

[1] The results of operations and financial positions prior to April 1, 1999 may have been different if Hydro One had been a stand-alone corporation with its own management and capital structure, rather than a business unit of Ontario Hydro.

[2] Operation, maintenance and administration for 1999 includes a net charge of $24 million for a staff reduction program and the reversal of certain provisions. In 1997, Ontario Hydro's Board of Directors approved a charge in the amount of $79 million related to field operation centres, certain cost of programs, the consolidation of facilities and planned employee reductions.

[3] The transitional cost adjustment was a one-time charge related to the first three months of 1999 (see Note 7).

[4] The provincial debt guarantee fee was an annual fee equal to one-half of one percent (0.5%) of the total debt guaranteed by the Province outstanding as of the preceding December 31. This fee was eliminated effective April 1, 1999 (see Note 17).

[5] The gain on sale of investment relates to the sale of the Company's 25% equity interest in Ontario Quinta (see Note 8).

[6] As of April 1, 1999, Hydro One is required to make payments in lieu of corporate taxes (see Notes 2 and 10).

Year ended December 31 (Canadian dollars in millions)	2000	1999	1998	1997	1996
Financial position data					
Total assets	9,997	10,090	9,435	9,059	9,002
Other financial data					
EBITDA[7]	1,273	1,292	1,333	1,111	1,278
Capital expenditures:					
Transmission	280	327	171	176	161
Distribution (including retail)	175	186	188	126	147
Other	14	16	35	22	6
Ratios					
Net asset coverage on long-term debt[8]	1.90	1.83	1.43	1.37	1.33
Interest coverage ratio[9]	2.49	2.26	1.82	1.37	1.63
U.S. GAAP (Canadian dollars)[10]					
Net income and comprehensive income	310	404	446	272	379
Retained earnings	200	292	–	–	–
Interest coverage ratio[9]	2.31	2.33	1.77	1.45	1.62
Operating statistics					
Transmission:					
Units transmitted (TWh)	146.9	144.1	143.0	144.8	143.0
System peak demand (MW)	23,428	23,435	22,443	22,197	22,321
Total transmission lines (kilometres)	28,490	28,889	29,066	29,080	29,080
Distribution:					
Units distributed (TWh)	17.6	18.1	18.3	18.8	18.6
Total distribution lines (kilometres)	113,880	113,400	116,947	119,182	118,985
Customers[11]	957,474	933,990	957,835	973,439	962,943
Total employees	4,468	5,632	5,221	5,222	5,478

[7] EBITDA represents income before financing charges, provision for payments in lieu of corporate income taxes, depreciation and amortization and does not include financing income.

[8] Net asset coverage on long-term debt is calculated as total assets minus total liabilities excluding long-term debt (including current portion) divided by long-term debt including current portion. Net asset coverage on long-term debt would have been 1.80 had common and preferred dividends been paid in 1999.

[9] Interest coverage is calculated as income before interest expense and provision for payment in lieu of corporate income taxes divided by total interest cost. In 1999, the gain on the sale of the investment in Ontario Quinta is excluded from income for the purpose of calculating interest coverage.

[10] The amounts for purposes of U.S. GAAP have been restated to reflect a regulatory asset for environmental costs (see Note 23).

[11] As of April 1, 1999, Hydro One served approximately 934,000 retail customers. The reduction over prior years was a result of statutory annexations of a small portion of facilities by several municipal electricity utilities (see Note 11).

Sir Graham Day
Chairman of the Board
Hydro One Inc.
Hantspo:t, Nova Scotia

Eleanor Clitheroe
President and Chief Executive Officer
Hydro One Inc.
Toronto, Ontario

Richard Auchinleck
President and Chief Executive Officer
Gulf Canada Resources Ltd.
Calgary, Alberta

Robert E. Gillespie
Chair and Chief Executive Officer
General Electric Canada Incorporated
Mississauga, Ontario

Chair, Audit and Finance Committee
Hydro One Inc.

Allister Graham
Corporate Director
Toronto, Ontario

Chair, Corporate Governance Committee
Hydro One Inc.

Dona Harvey
Management Consultant
The Talaria Group, Kitchener, Ontario

Chair, Human Resources and Public Policy Committee
Hydro One Inc.

Stephanie Kushner
Vice President and Treasurer
FMC Corporation
Chicago, Illinois

Radcliffe Latimer
Corporate Director
Toronto, Ontario

Chair, Regulatory, Health, Safety and Environment Committee
Hydro One Networks Inc.

Douglas McCaig
Corporate Director
Fort Frances, Ontario

Gedas A. Sakus
Corporate Director
Toronto, Ontario

Martin Bernard Syron
Chair
Cara Operations Limited
Toronto, Ontario

Roslyn Watson
President
Watson Ventures
Boston, Massachusetts

Sir Graham Day is Chairman of the Board of Directors of Hydro One Inc. Sir Graham is Counsel to the Atlantic Canada law firm Stewart McKelvey Stirling Scales. He holds the Herbert Lamb Chair in Business at the Dalhousie Business School and is Chancellor of Dalhousie University. In 1993, he retired as Chairman of Cadbury Schweppes plc and PowerGen plc. Sir Graham was previously Chairman and Chief Executive Officer of British Shipbuilders and The Rover Group plc, and Chairman of British Aerospace plc. Sir Graham was knighted by Queen Elizabeth II in 1989 for service to British industry.

Eleanor R. Clitheroe is President and Chief Executive Officer of Hydro One Inc. Ms. Clitheroe has also served as Chief Financial Officer, Chief Development and Transition Officer for Ontario Hydro, and Executive Vice President, Corporate Business Group. Prior to joining Ontario Hydro, she served as Deputy Minister of Finance for the Province of Ontario and Assistant Deputy Minister, Ministry of Treasury and Economics. Before that she was Vice President, Corporate Finance with the Canadian Imperial Bank of Commerce. Ms. Clitheroe is the eighteenth Chancellor of the University of Western Ontario.

Richard H. Auchinleck is President and Chief Executive Officer of Gulf Canada Resources Ltd. Mr. Auchinleck joined Gulf Canada in 1976 and held a variety of senior positions before becoming President and Chief Executive Officer in 1998. Mr. Auchinleck also serves on the Boards of Directors of Canadian Energy Research Institute, Canadian Heavy Oil Association and Gulf Indonesia.

Robert E. Gillespie is Chair and Chief Executive Officer of General Electric Canada Incorporated. He joined General Electric in 1952 and held a variety of senior positions before becoming Chair and Chief Executive Officer in 1992. Mr. Gillespie also serves on the Boards of Directors of Camco Inc., Husky Injection Molding Systems Ltd. and Valmet Canada.

Allister P. Graham recently retired as Chair of The Oshawa Group Limited, where he held a number of senior positions before becoming Chair and Chief Executive Officer in 1990. Mr. Graham also serves on the Board of Directors of Manulife Financial Corporation, Dylex Limited and the Nash Finch Company (U.S.).

Dona Harvey is a management consultant with the Talaria Group. She has worked in senior management positions at daily newspapers in Edmonton, Winnipeg, and Vancouver, and in public affairs in Toronto. Ms. Harvey served on the Board of Directors of Ontario Hydro from 1993 to 1999.

Stephanie Kushner is Vice-President and Treasurer of FMC Corporation. Ms. Kushner joined FMC in 1989 after holding senior positions with Amoco Corporation and Homestake Mining Company. She has since served as Chief Financial Officer of FMC Gold Company, Group Financial Director of FMC (UK) and Director of Financial Planning of FMC Corporation.

Radcliffe Latimer previously served as Chair of Prudential Assurance Corporation Canada and President and Chief Executive Officer of TransCanada Pipelines Ltd. Mr. Latimer has also held senior positions with CN Railways, Algoma Central Corporation and Royal Securities. Mr. Latimer is currently a member of the Board of Directors of Algoma Central Corporation and Citibank Canada.

Douglas McCaig has been Chair of the Fort Frances Public Utilities Commission since 1971 and is a former Chair of the Municipal Electric Association and Northwest Energy Inc. Mr. McCaig is currently Chair of Northwest Mobility.

Gedas A. Sakus recently retired as President of Nortel Technology. He had been with Nortel Networks since 1962, becoming President of Northern Telecom Canada Limited in 1990, and President of Nortel Technology in 1996. Mr. Sakus also served on the Board of Directors of Bell-Northern Research and Teledirect and now serves on the Board of Directors of BCE Emergis.

Martin Bernard Syron is Chair of Cara Operations Limited. He joined Harvey's Foods Limited in 1968 and became President and Chief Executive Officer of Cara Operations in 1984. He was promoted to Chair and Chief Executive Officer in 1990 and Chair in 1997. Mr. Syron also serves on the Board of Directors of Second Cup Coffee Co., The Spectra Group and St. Michael's Hospital.

Roslyn M. Watson is President and founder of Watson Ventures. Ms. Watson currently serves as a Director of Dreyfus-Laurel Mutual Funds, American Express Centurion Bank and Harvard Pilgrim Inc., and is a trustee of the Hyams Foundation. From 1990 until 1998, Ms. Watson was a member of the Board of Directors of Massachusetts Electric.

as at December 31, 2000

Each committee proposed a draft mandate to the Corporate Governance Committee, which is responsible for recommending committee mandates to the Board for approval. Each of the Board Committees has adopted an Annual Work Plan and in each case, a company officer has been appointed as the primary management liaison with the respective Committee Chairs in order to assist with committee work.

Audit and Finance Committee

The Audit and Finance Committee is responsible for reviewing and making recommendations to the Board of Directors regarding the financing plans and objectives of the Company. The Audit and Finance Committee reviews the audited annual Consolidated Financial Statements and related management's discussion and analysis disclosures as well as financial statements issued in connection with any offerings of our securities as required by regulatory authorities. The committee met five times in 2000.

Members:
Robert E. Gillespie, Chair
Eleanor R. Clitheroe
Sir Graham Day
Allister P. Graham
Stephanie Kushner
Radcliffe Latimer
Martin Bernard Syron

Corporate Governance Committee

The Corporate Governance Committee is responsible for the Board's governance of the Company. It recommends issues to be discussed at Board meetings, annually reviews the mandates of each committee of the Board of Directors, monitors the quality of management's relationship with the Board of Directors and recommends suitable nominees for election to the Board of Directors. The committee met five times in 2000.

Members:
Allister P. Graham, Chair
Eleanor R. Clitheroe
Sir Graham Day
Robert E. Gillespie
Dona Harvey

Human Resources and Public Policy Committee

The Human Resources and Public Policy Committee is responsible for reviewing the status of the Code of Business Conduct, the appropriateness of our current and future organizational structure, succession plans for corporate and divisional officers, review of the performance and remuneration of our senior executives, including recommending to the Board the remuneration of the President and Chief Executive Officer, and the identification, assessment and provision of advice to the Board of Directors on public affairs issues that have significant impact on us. The committee met eight times in 2000.

Members:
Dona Harvey, Chair
Eleanor R. Clitheroe
Sir Graham Day
Doug McCaig
Gedas A. Sakus
Martin Bernard Syron

Regulatory, Health & Safety and Environment Committee

Throughout 2000, the Regulatory, Health, Safety and Environment Committee of Hydro One Networks Inc. was responsible for ensuring compliance with all applicable occupational health, safety and environmental legislation as well as any applicable regulatory requirements. The committee establishes compliance programs, policies, standards and procedures, formulates contingency plans and reviews compliance actions and reports. The committee met six times in 2000.

Members:
Radcliffe Latimer, Chair
Eleanor R. Clitheroe
Richard Auchinleck
Dona Harvey
Doug McCaig
Roslyn Watson

Senior Officers of the Company and Operating Subsidiaries

Chairman of the Board and Senior Officers of Hydro One

Hydro One Inc.

Sir Graham Day
Chairman of the Board

Eleanor Clitheroe
President and
Chief Executive Officer

Malen Ng
Executive Vice President and
Chief Financial Officer

Joan Prior
Executive Vice President
General Counsel and Secretary

Rod Taylor
Executive Vice President
Planning and Development

Senior Officers of Operating Subsidiaries

Hydro One Networks Inc.

Eleanor Clitheroe
Chair

Malen Ng
President and Chief Executive Officer

Hydro One Network Services Inc.

Eleanor Clitheroe
Chair

Rod Taylor
President and Chief Executive Officer

Hydro One Remote Communities Inc.

Eleanor Clitheroe
Chair

Les Horswill
President and Chief Executive Officer

Hydro One Telecom Inc.

Eleanor Clitheroe
Chair

Joan Prior
President and Chief Executive Officer

Hydro One Markets Inc.

Eleanor Clitheroe
Chair

Kathryn Beaton
President and Chief Executive Officer

Ontario Hydro Energy Inc.

Eleanor Clitheroe
Chair

Mike Miller
President and Chief Executive Officer

Corporate Information

Corporate Address

Hydro One Inc.
483 Bay Street
Toronto, Ontario M5G 2P5
Web site: www.HydroOne.com

Contact Information

General Inquiries
For general inquiries, please contact:
Phone: (416) 345-5000 in Toronto
Toll-free: (877) 955-1155
within Ontario
E-mail: webmaster@HydroOne.com

Media Inquiries
For media inquiries about
Hydro One, please contact the
Media Desk at:
Phone: (416) 345-6868 in Toronto
Toll-free: (877) 506-7584
within Ontario

Financial Information
For inquiries relating to the financial information contained in this report, please contact:
Ian Chadsey
Director, Investor Relations
Phone: (416) 345-6136
Fax: (416) 345-6225
E-mail: ian.chadsey@HydroOne.com

Publications

To receive additional copies of this report, please contact
Hydro One, Corporate Affairs at:
Phone: (416) 345-5800
Fax: (416) 345-6144
E-mail: request@HydroOne.com

This annual report is also available in a downloadable format on our web site at www.HydroOne.com

Auditors

Ernst & Young LLP

We are proud of our employees and the contribution they make to the success of our company. We've featured some of them throughout this report, and would like to thank them for their participation.

At Hydro One, community involvement has been a way of life for nearly a century. In 2000, we launched a number of new integrated corporate social responsibility programs that help to strengthen our connections with communities where our customers and employees live and work.

Focus on Safety

Our new Community Citizenship Program provides charitable donations to innovative community programs. With a focus on community safety initiatives, Hydro One initiated important partnerships with three of the leading injury prevention organizations in Canada: Safe Kids Canada, Safe Communities Foundation and Smartrisk. A total of $1 million was donated to these and other programs throughout the province.

Employee Participation

Supporting employees in their volunteer activities is a pillar of the Community Citizenship Program. The Employee Volunteer Grant Program provides donations to charities to which Hydro One employees provide their time and talents. Volunteer fire departments, hospitals, schools, Boy Scout and Girl Guide groups are just some of the recipients of this initiative.

Hydro One Employees' and Pensioners Charity Trust Campaign encourages employees to donate to their charities of choice through payroll deductions. In 2000, more than $745,000 was raised through donations and special events, benefiting more than 800 charitable organizations.

Sponsorship Activities

Sponsorships enrich the cultural fabric of communities. Hydro One was proud to sponsor Power to the People, an exhibit on the history of electricity in Ontario, at the Royal Ontario Museum. Plans were laid for an exciting sponsorship of the Hydro One 2001 Canada Summer Games Torch Relay, which will travel across Ontario before making its way to the Games in London, Ontario. Hydro One staff participated in a selection of fall fairs, culminating in a sponsorship of the Winter Garden at the Royal Agricultural Winter Fair. A new addition to our sponsorship mix is supporting employee teams in sporting events, as well as children's sports teams, where our staff are involved as volunteers.

Connecting

with our customers